HEARING TO REVIEW FEDERAL MILK MARKETING RULEMAKING PROCEDURES

HEARING

BEFORE THE

SUBCOMMITTEE ON
LIVESTOCK, DAIRY, AND POULTRY

OF THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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HEARING TO REVIEW THE FEDERAL MILK MARKETING RULEMAKING PROCEDURES

TUESDAY, APRIL 24, 2007

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON LIVESTOCK, DAIRY, AND POULTRY,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The Subcommittee met, pursuant to call, at 10 a.m., in Room 1300 of the Longworth House Office Building, Hon. Leonard L. Boswell [Chairman of the Subcommittee] presiding.

Members present: Representatives Boswell, Gillibrand, Kagen, Holden, Baca, Donnelly, Costa, Peterson (*ex officio*), Hayes, Conaway, Smith, Walberg, and Goodlatte (*ex officio*).

Staff present: Chandler Goule, Tyler Jameson, John Riley, Sharon Rusnak, Lisa Shelton, April Slayton, Debbie Smith, Kristin Sosanie, Lindsey Correa, John Goldberg, Alise Kowalski, and Jamie Weyer.

OPENING STATEMENT OF HON. LEONARD L. BOSWELL, A REPRESENTATIVE IN CONGRESS FROM NORTH CAROLINA

Mr. BOSWELL. Well, good morning and welcome to our hearing today. We appreciate you being here to enlighten us on the Federal Milk Marketing Order. I found it to be a very interesting process which requires a little learning. I would like to thank you and I appreciate you taking the time to address some of the concerns of the rulemaking procedure for Federal Milk Marketing Orders. A special thanks to our witnesses for testifying before the Committee and a special welcome to our two Iowans, Warren Erickson from my district, and Doug Wells from Mr. King's district. I very much look forward to hearing their testimony as well as the rest.

Since January, I have been on sort of a crash course in dairy policy, not having an extensive background in the dairy industry, although I did grow up milking cows, but I did it the old-fashioned way and I think my father might have celebrated my departure, and I say that respectfully because after I left the farm when we were hand-milking, he got a surge system, and I came home the first time on leave from the military and I said, "What is going on here, Pop?" He said, "Since you are not here to milk your 10 cows," or however many it was I was assigned, "I found something to take your place." It was pretty nice.

But anyway, I have been trying to learn all of this process as quickly as I can and I find it very, very challenging. A running joke I hear over and over around here is that there are three people in

D.C. who fully understand dairy policy; however, two of them aren't telling the truth.

With that being said and as we begin to learn more about the issues of the dairy industry, and as I spoke to dairy producers in my district, a recurring theme kept arising: the rulemaking process for Federal Milk Marketing Orders takes too long, often taking up to 2 years to get a rule approved and implemented by the USDA. Many in the industry who have concerns over of the length of the rulemaking procedures point to the California model. Granted that the California order covers only one state, I might say a very large and a very important state, and the Federal Orders cover almost 70 percent of the milk marketing in the United States. The California model has a time table that must be met. These time tables ensure that hearings are held promptly and rulings are passed and implemented in a timely fashion. One of the major complaints with the current Federal Milk Marketing Orders is that they do not currently represent the dairy market of 2007.

After reading through much of the testimony, there is a consensus throughout the dairy industry that the rulemaking procedures take too long, but there are varying views on how to achieve a more streamlined process. We are interested in hearing about the new steps that the Agricultural Marketing Service is implementing to ensure quicker turnaround on rulemaking. I appreciate USDA recognizing that there has been a problem in the amount of time that it has taken some rules to pass and to be implemented, but I also welcome discussion on further improvements that can be made. Federal Milk Marketing Orders were created to assist the marketing of dairy by dairy producers and have done just that for years. We must ensure that the process is quick and efficient and represents what the dairy market of 2007 looks like.

As we look forward toward the 2007 Farm Bill discussion that we are in the process of doing right now, we will be looking at different proposals to change the Federal Milk Marketing Order System. One such proposal is to create a commission to review and recommend ways to streamline the system, increase its responsiveness to market forces and ensure that it is still serving the best interests of the industry and the consumers. I look forward to more conversation on that issue. I find it interesting that the USDA acknowledges the consolidation of dairy industry on the heels of last week's hearing on the market structure of the livestock industry. They recognize that today we have considerably more dairy producers than processors and grocers. With only 10 retail grocer companies, concentration of the dairy industry is evident. There is some concern that the grocery companies, without the Federal Milk Marketing Orders, could push milk prices down to the processing industry, which in turn would push lower prices down to the dairy farmers. Dairy is not a commodity that can be withheld from the market until prices improve. Since dairy must be sold every day, producers are susceptible to having to sell their product regardless of the price. This is one reason why the Federal Milk Marketing Orders were created, to balance competition in the dairy industry.

I appreciate everyone taking the time to discuss the issues at hand. I welcome further discussion on the Federal Milk Marketing Order. So thank you again for joining us today and at this time,

I would like to turn it over to my good friend and colleague, the Ranking Member, Robin Hayes, from North Carolina, for any opening remarks he might wish to make.

[The prepared statement of Mr. Boswell appears at the conclusion of the hearing:]

OPENING STATEMENT OF HON. ROBIN HAYES, A REPRESENTATIVE IN CONGRESS FROM NORTH CAROLINA

Mr. HAYES. Thank you, Mr. Chairman, and thank you for holding the hearing today. Thank you to all of the witnesses for your time and attention to this important matter.

As you are all aware, during my chairmanship in the previous two Congresses, dairy was under the jurisdiction of another subcommittee, so I have not had the opportunity to fully immerse myself in what is among the most complex problems—excuse the play on words—program under the Ag Committee's jurisdiction. I have been looking forward to this hearing as a chance to learn as much as I can about this industry, especially considering it is the only farm bill program that the Subcommittee has jurisdiction over. Now, as we get into these issues, I think it will be pretty clear that some of us up here on the dais tend to take a free market approach, while others tend to favor some level of government involvement in the marketplace. Where I think we all agree is that if the government is involved, it needs to be a facilitator, not an impediment.

What I know about the Federal Milk Marketing Order System: the industry faces some fairly cumbersome hurdles, both administrative and legislative, that only serve to hamper efforts to improve the Orders for all participants, and I appreciate that USDA has acknowledged this fact and is working hard to do what they can to improve the process. I recognize also that there is a consensus among the industry that more needs to be done. I appreciate all of the witnesses, again, for being here and I look forward to the discussion of this important issue. Thank you, Mr. Chairman.

[The prepared statement of Mr. Hayes appears at the conclusion of the hearing:]

Mr. BOSWELL. Thank you, Mr. Hayes, and I appreciate your comments. I think, at this time, we are ready to start with our first panel and so thank you very much. I would like for each of you to just for a moment, for all present, to introduce yourselves and then we will start with——

Mr. GOODLATTE. Mr. Chairman?

Mr. BOSWELL. Where is Mr. Goodlatte? Oh, there he is. I am sorry.

Mr. GOODLATTE. I wonder if I might make a statement?

Mr. BOSWELL. I expect you would be up here for some reason or other. We would like to recognize the Ranking Member of the full committee, Mr. Goodlatte, of course.

OPENING STATEMENT OF HON. BOB GOODLATTE, A REPRESENTATIVE IN CONGRESS FROM VIRGINIA

Mr. GOODLATTE. Thank you, Mr. Chairman. I very much appreciate your holding this hearing and I appreciate the opportunity to give a few remarks.

I found that the easiest way to clear a room is to begin talking about dairy policy. Few markets suffer such an extreme level of government regulation. Dairymen are over-regulated in just about every aspect of their business. When we discuss dairy policy in this Subcommittee, we must always be cognizant that the slightest change can have severe repercussions. As such, it is very rare for the Agriculture Committee to consider dairy proposals that are acceptable to all players. However, as the full committee traveled throughout the country last year, a common theme among dairy producers and processors emerged: the Federal Milk Marketing Order System needs to be more responsive.

As most of us have become painfully aware, even simple changes to Federal Orders can often take a year or more to accomplish. For example, dairymen in my region of the country petitioned for a change in October of 2005 to adjust transportation credits in the Southeast and Appalachian Orders. The USDA proceeded to consider this proposal on an expedited basis. A year later, the Department published an interim rule that covered only a portion of the original petition. As we sit here today, this rulemaking is still open and the problem for my dairymen has yet to be resolved. It will be easy to sit here and blame the USDA for the length and complexity of the process. If we did that, however, we would be ignoring the fact that the USDA is simply abiding by the laws our predecessors created. Likewise, we would be ignoring the effect the various industry participants have in slowing down the process when it suits them to do so. Unlike other Federal rulemaking procedures that are regulated under the Administrative Procedure Act, Federal Milk Marketing Order rulemaking is regulated by the arcane procedures of the Agricultural Marketing Agreement Act.

The USDA has some discretion to improve their internal management of the process, and we will hear today that this is something the USDA Dairy Program is committed to doing. Unfortunately, that will only get us so far. The rest needs to be done by the Members of this Committee. As we begin this process, we are fortunate that we have a successful model that we can evaluate. There are many aspects of the California system that we could incorporate into a Federal system, which is encouraging. If we are successful in capturing the best of both systems, we may actually have finally done something good for dairy, at least in terms of making our decisions more expeditiously and in a manner that will be more responsive to the marketplace. Thank you, Mr. Chairman.

[The prepared statement of Mr. Goodlatte appears at the conclusion of the hearing:]

Mr. BOSWELL. Thank you, Mr. Goodlatte, and again, I apologize for not recognizing your presence. So we will take note of that the next time. At this time, I would request the other Members to submit their opening statements for the record so the witnesses may begin their testimony and give us ample time for questions. And we would like to welcome our first panel, as I said earlier, to the table. And so Administrator Day, I want to just ask you to introduce your two deputies and then we will introduce Mr. Krug and we will get started.

STATEMENT OF LLOYD DAY, ADMINISTRATOR, AGRICULTURAL MARKETING SERVICES, U.S. DEPARTMENT OF AGRICULTURE; ACCOMPANIED BY DANA COALE, DEPUTY ADMINISTRATOR, DAIRY PROGRAMS, AMS, U.S. DEPARTMENT OF AGRICULTURE; AND RON BOSECKER, ADMINISTRATOR, NATIONAL AGRICULTURAL STATISTICS SERVICE, U.S. DEPARTMENT OF AGRICULTURE

Mr. DAY. Well, Mr. Chairman and Members of the Subcommittee, good morning and thank you for the invitation to appear before you today. Accompanying me is Ronald Bosecker, the Administrator of the National Agricultural Statistics Service, and Dana Coale, the Deputy Administrator of AMS's Dairy Programs. The following remarks will provide a brief overview of the Federal Milk Marketing Order System, including a review of its rulemaking procedures. My complete statement has been submitted for the record.

I wanted to briefly touch on the current status of the U.S. dairy industry. Although the dairy industry is facing increased feed costs and higher energy costs, slowed increases in milk production and robust demand for dairy products are resulting in stronger milk prices. The average Federal Order uniform milk price of $15.61 per hundredweight reported for March of this year is a year-over-year increase of more than 23 percent. Internationally, the United States has become a leading exporter of nonfat milk products since 2005 and is expected to remain the leader through 2007 and beyond. We expect exports of 295,000 metric tons for 2007, an increase of 1.7 percent over 2006 levels, even as the overall market is contracting slightly. The tight international markets led to higher prices, which in turn have boosted domestic prices.

AMS administers, among other programs, the Federal Milk Marketing Order Program. Federal Milk Marketing Orders are authorized by the Agricultural Marketing Agreement Act of 1937, as amended. The Act authorizes the Secretary of Agriculture to establish and maintain such orderly marketing conditions as will provide, in the interest of producers and consumers, an orderly flow of the supply to avoid unreasonable fluctuations in supplies and prices. Funded by user fees, the 10 Federal Orders cover a majority of the United States and are a major part of milk marketing in the United States. More than 90 percent of U.S. milk is marketed under either Federal Orders or under similar regulations issued by state governments. A milk market administrator administers each Order.

The Federal Milk Marketing Order System facilitates the marketing of milk by dairy farmers and their cooperative associations. Federal Orders regulate handlers who buy milk from farmers and their cooperatives. Federal Orders set minimum prices paid by regulated handlers for milk according to how it is used. Dairy farmers who supply enough milk to the market's fluid handlers to meet an Order's performance standards share in the revenue of all milk sales under the Order. Regardless of how an individual dairy farmer's milk is used, the farmer receives at least the blend or market average minimum price for milk sold in all classes. Federal Milk Marketing Orders provide a structured means of sharing the benefits and compensating for the additional costs for supplying Class

I needs of a market and prevent dairy farmers from being subject to undue pressures from buyers in the marketing of a highly perishable product.

Milk Marketing Orders benefit dairy farmers, manufacturers and processors, and others in the marketing chain, in other ways. In addition to market information made available by Dairy Market News, the Federal Milk Order Program amasses a considerable amount of data on producer numbers, milk marketings, prices, fluid milk sales and dairy product production that AMS publishes for the use of all market participants. These data are made available over the Internet and thus are more current and accessible than ever before.

It should be noted that the Federal Milk Marketing Order Program is a marketing program, not a price or income support program. USDA operates the Milk Price Support Program and the Milk Income Loss Contract Program, or MILC Program, for those latter purposes. Federal Milk Orders do not regulate dairy farmers. Dairy farmers are able to produce as much milk as they wish and they can sell to any handler who is willing to buy their milk. Federal Orders do not guarantee a market for a farmer's milk. Farmers must find their own market and must arrange for the delivery of their milk to the handlers and bear those marketing costs.

Further up the marketing chain, the grocery industry is also highly concentrated. Absent Milk Marketing Orders, the potential exists to push lower milk prices down to handlers, who in turn could push lower prices down to dairy farmers to below a sustainable long-run average production cost level. The perishable nature of raw farm milk puts the dairy farmer in a vulnerable negotiating position. Raw milk, unlike store-bought commodities, cannot be withheld from the market in an effort to gain a better price. Federal Milk Orders help balance the competition between many dairy farmers and relatively few fluid milk processors.

The Agricultural Marketing Agreement Act of 1937, as amended, requires that formal rulemaking procedures be used to make changes to the Federal Milk Marketing Order. The process is extensive and time consuming but provides for maximum industry participation and transparency. The industry offers proposals, provides testimonies in support or in opposition to proposals, and may cross-examine the witnesses at public hearings before an Administrative Law Judge, submit briefs and proposes findings of facts, comments on recommended decisions, and produces approved final decisions to referenda before any changes to an Order are effective.

AMS is aware of the concern about timely decisions and in response undertook an extensive internal review of its part in the process and developed several new rulemaking initiatives and customer service standards. During this process, AMS consulted with other organizations, including the California Department of Food and Agriculture, to determine best practices that could be incorporated into the Federal rulemaking process. Our goal is to improve timeliness while maintaining transparency and the opportunity for public involvement that currently exists. Some of the steps initiated by AMS include having meetings to discuss issues with interested parties before the proposals are submitted; holding pre-hearing information sessions to discussion proposals received

with interested parties before the *ex parte* rulemaking restrictions apply; we have had held one such session to date on the current Class III and IV proceeding; developing supplemental rules of practice to better define public input timelines once the formal rulemaking process begins; and procuring the services of court reporters, in terms of best value rather than lowest cost, to reduce transcript delivery times and improve their quality and accuracy, and this has been very successful.

Under the new customer service standards, we are planning to have amendments issued within 14 months for any non-emergency rulemaking proceeding. This process would allow 3 months in total for public participation. In situations when emergency marketing conditions warrant the omission of a recommended decision, the Department could move from a hearing to final amendments in 10 months or less. These new standards are reducing the amendatory time from more than 2 years to around 1 year. We have had extensive discussions with the industry regarding the time-frames necessary for insuring sound, reasonable decisions that allow maximum public participation, and have concluded that our revised process will yield better results than a mandated timeframe.

My written testimony for the record discusses in detail why the Department is opposed to mandated time-frames. The problems associated with mandated time-frames include the inability to respond to urgent issues, such as those presented by the hurricanes in 2004 and the potential for increased litigation. It is important to understand that the Federal Milk Marketing Order Program continually changes to reflect relevant marketing conditions facing the dairy industry. Since 2000, AMS has undertaken 19 rulemakings to amend Federal Orders, requiring the publication of more than 62 documents in the *Federal Register*. Of these rulemakings, 14 have been finalized.

Finally, I would like to stress, again, that Federal Milk Marketing Orders today remain an important tool for dairy farmers. AMS will continue to work with all sectors of the U.S. dairy industry to administer Federal Milk Marketing Orders so that dairy farmers are assured of a reasonable minimum price for their milk, and consumers are assured of an adequate supply of fluid milk to meet their needs throughout the year. This concludes my statement, Mr. Chairman. I would be pleased to respond to any questions.

[The prepared statement of Mr. Day appears at the conclusion of the hearing:]

Mr. BOSWELL. Well, thank you, Administrator Day. I thought you might introduce your two deputies, so allow me, with your permission, to do that with you or for you. But you have Dana Coale from Dairy Programs with you. Welcome. Glad to have you here. I want the panel to know that. And also Ron Bosecker. Glad to have you here.

Mr. BOSECKER. Thank you, sir.

Mr. BOSWELL. And with that, I would like to recognize Mr. Krug, Director of Marketing Services, California Department of Food and Agriculture, from Sacramento. Welcome, Mr. Krug. We recognize you at this time.

STATEMENT OF KELLY KRUG, DIRECTOR, DIVISION OF MARKETING SERVICES, CALIFORNIA DEPARTMENT OF FOOD AND AGRICULTURE

Mr. KRUG. Thank you and good morning. My name is Kelly Krug. I am the Director of the Division of Marketing Services of the California Department of Food and Agriculture. Thank you for the invitation to speak to you today about the hearing process used by the California dairy pricing and pooling systems.

I direct the division of the Department that administers the state's milk pooling and pricing system. For more than 70 years, the Department's California dairy pricing program has worked to carry out four goals established by the California Legislature, which are stated in the Food and Agricultural Code. They are: (1) to maintain an adequate and continuous supply of pure and wholesome food milk to consumers; (2) to eliminate unfair dairy trade practices; (3) promote and encourage intelligent production and orderly marketing; and (4) maintain a reasonable level of stability and prosperity in the California dairy industry. These goals address the interest of all parties, including producers, processors, cooperatives, retailers and consumers.

California's dairy pricing system is similar to Federal Milk Marketing Orders. Both rely on established minimum farm milk prices for producers. USDA's Federal Milk Marketing Orders regulate more than ⅔ of the Grade A milk marketed today. California is the principal milk production area that does not fall under the jurisdiction of a Federal Order and has maintained its own state order marketing program since the passage of the Young Act in 1935. California also has operated a milk pooling program since the passage and implementation of the Gonsalves Milk Pooling Act in 1968, which provides for dairy producers to share the revenue from the sales of all classes of milk. Again, California's operation of milk pooling is quite similar to pooling that is done in Federal Milk Marketing Orders.

Currently, California operates its milk pricing plan with two marketing areas, northern California and southern California. Each marketing area has a separate but essentially identical stabilization and marketing plan. Each plan specifies the formulae for establishing minimum prices for California's five classes of milk. Much like the Federal Milk Marketing Orders, and to promote stability in the state's dairy industry, California's milk marketing program establishes minimum prices that processors must pay for food grade or for Grade A milk received from dairy farms, based on end-product use. These prices are established within defined marketing areas where the milk production and marketing practices are similar.

The California pricing system was designed to encourage innovation and to react quickly to market signals. Minimum farm prices are determined by supply and demand signals that are based upon actual market conditions and prices for manufactured dairy products. These formulae are established through a public hearing process in which interested parties offer testimony and evidence relating to the proposed formulae. Revisions to these pricing formulae, other provisions of the stabilization marketing plans, and provisions of the pooling plan for market milk are made only after a

public hearing has been held. Most hearings are initiated by entities representing either milk producers, cooperatives or milk processors, but they can be requested in writing by any interested party. Infrequently, the Department will call for a hearing on its motion. This formal hearing process generally allows for changes to be implemented in approximately 3 to 5 months.

Next, I will outline the steps of the hearing system. The request for a hearing must be received in writing and it must specify which plan is recommended for change, that is, which of the stabilization plans or the milk pooling plan. A request must explain why a change is sought and must include relevant analysis and data along with the proposed implementation language. Once a request is received, the Department has 15 calendar days to decide if a hearing would be granted. If the Department accepts the request, a formal hearing announcement is released with a time table for the hearing events. A filing period for submission of alternative proposals is identified and a few weeks before the hearing is conducted, the Department will hold a pre-hearing workshop. The workshop allows the requester, and any parties filing alternatives, to explain their proposals. The Department also performs initial analyses of all the proposals, which are released at the pre-hearing workshop. Departmental exhibits are made available to the public 7 days prior to the date of the hearing, then the hearing is conducted.

Most hearings require 1, or possibly 2, days to complete. The Department generally allows up to 10-day brief filing period for participants to clarify or amplify their testimony presented at the hearing. From the date of the hearing completion, which is the end of the oral testimony, the Department is required by the Food and Agriculture Code to implement any changes resulting from the hearing within 62 days. The Code also requires a 10-day notice to the public of the upcoming changes, which reduces the analysis time to 52 days from the date of the hearing closure. I have included a hearing timeline diagram with my testimony that further explains the hearing process. Also a summary brochure is included that provides details of the dairy hearing process to interested parties.

This concludes my testimony. Thank you for the opportunity to speak to you today about the hearing process used for the California dairy pricing and pooling systems. If you have any questions regarding our program, I would be pleased to try to answer them. Thank you.

[The prepared statement of Mr. Krug appears at the conclusion of the hearing:]

Mr. BOSWELL. Well, thank you, Mr. Krug. I think we will have a question round now. I will ask a couple questions and I will remind Members that we are going to try to limit to 5 minutes, then we could have a second round if we need, and I will adhere to that myself. But you mentioned something, Administrator Day, about the number of reforms to speed up the process. Can you expand a little bit on the steps that you are taking? Just briefly, what steps are you actually suggesting you are going to take?

Mr. DAY. Sure. I would be happy to, Mr. Chairman. First, we, like you, recognize that speed is very important to be responsive as

possible to the dairy industry. Therefore we undertook an extensive review, meeting with folks from California and with industry to determine what we could do to speed things up, to understanding, first off, when we are going into a hearing, what the issues are, the relevant issues are, to bring the players together in this informal meeting process, which is the next step, in order to get all of our ducks in a row, so to speak, in order to when we actually announce a hearing, that folks are prepared for that hearing and they come in and they have that opportunity to testify in a clean and efficient way. We then moved on to develop administrative procedures that we are going to put in place for ourselves and for the public and we are going to be publishing that very shortly. That will talk about the timelines for public participation, which will be streamlined as well, as well as looking at our own internal processes to make that move faster. And then the third area is court reporters. These are legal proceedings and so the transcript, which can go on for—the hearings sometimes go on for weeks—need to be done in a very efficient, effective and accurate way. And so we have moved to hiring best value instead of—or the reporters that are the best, regardless of the price, so that we are able to get accurate statements and an accurate body of evidence that we can present to the public in a more efficient way.

Mr. BOSWELL. Well, thanks very much. I think I will move over to Mr. Krug just for a moment. In the California State, where you enforce tight deadlines, have they been hard to enforce?

Mr. KRUG. I think that because they have been in place for a long time and there are a lot of long-term relationships in the dairy industry and producers, processors, co-op side, no, it has worked pretty well.

Mr. BOSWELL. What has been your major challenge?

Mr. KRUG. The time for economists to analyze the testimony thoroughly.

Mr. BOSWELL. Okay. And not to put you on the spot, but we are here for everybody to work together and I know you are too. Would you think that the USDA would be able to work a model similar to yours?

Mr. KRUG. Well, obviously, it would take a major change to the rule process. Possibly the regional issues that are involved make the Federal system more complicated.

Mr. BOSWELL. It would take more time?

Mr. KRUG. Yes. And I think that there, with probably some additional time, maybe a rigid calendar would work well, but you might need to pull it out or lengthen it somewhat.

Mr. BOSWELL. Thank you very much. Back to you Administrator Day, if I could. A few witnesses, in their written testimony, have suggested creating a Federal Orders commission with producers and processors charged with hashing out their own problems. What would you think of this proposal and would it be helpful to the agency to have the industry come together and offer solutions to some of the issues that come up with a Federal Order?

Mr. DAY. Well, whenever we can have industry consensus, it is always a good thing and that is one of the reasons why sometimes the rulemaking for the Federal Orders takes so much time, because there is not even anything close to industry consensus. I think a

commission is something that we would certainly be happy to look into and work with. We would have to make sure that it was composed of the right balance of folks from the industry and USDA and others, so we would be happy to work with that.

Mr. BOSWELL. I appreciate that. I think now that I am going to recognize my Ranking Member and ask what questions he might have. I want to recognize you for 5 minutes, sir.

Mr. HAYES. Thank you, Mr. Chairman. Mr. Day, last Friday, USDA announced a reporting error with regard to a National Agricultural Statistics Service survey of nonfat dry milk prices. Can you outline the process you are now involved in to examine the extent and impact of this reporting error?

Mr. DAY. I would like to turn that question over to the Administrator of NASS, Administrator Bosecker.

Mr. HAYES. Okay.

Mr. BOSECKER. Thank you for the question. Once again, my name is Ronald Bosecker. I am the Administrator of the National Agricultural Statistics Service, or NASS. We are the statistical arm of the Department, the data collection arm. We issue over 500 reports per year. One of those data series is the Dairy Products Prices Program that we have been collecting data from the plants for 8 years now, week in and week out, 52 weeks a year, and an error was brought to our attention recently. We made a revision in a recent report. We had noticed an anomaly in the prices, but there are technical reasons why the prices, which are weighted by product, could differ from the spot prices reported in Dairy Market News. And we were looking at the plants that might be involved and as a matter of fact, annually, we visit the plants and make sure they are reporting according to the rules, about what product or what prices are supposed to be included and what are supposed to be excluded, and we were in the process of this at the first instance that we heard that there were problems, there could be problems, and we were visiting all of the plants to make sure they were reporting correctly. As the problem grew, recently, we went back to plants again to re-verify and that is when the error was discovered.

Mr. HAYES. So from this point forward, what are you doing to examine the extent and impact of the error? I am not sure I got that answer.

Mr. BOSECKER. Currently, we are revisiting the plants again. That is part of our standard procedure. But we are instituting a special visitation for all of the plants to once again go over the inclusions and exclusions in the program and make sure that is thoroughly understood, and we are going to ask them, as well, to review the data they have reported for the last year and make sure that the reports that we have gotten from all the plants are accurate.

Mr. HAYES. Okay. When are you going to report back to us on the impact of this error?

Mr. BOSECKER. There will be the data collection period over the 45 days and then there will be the processing of the data that we have and the economic analysis and then the calculations of the impact of any changes that are found, and so I would suspect July might be the earliest that we could have answer for you.

Mr. HAYES. Okay, we won't hold dinner for you, but get that to us when you can. Mr. Day, do you intend to seek legislative changes in the Agricultural Adjustment Act to expedite processing of Federal Order amendment petitions? And also, time is getting short. You have expressed in your testimony that USDA is doing a number of things to speed up the decision making process of the Department, as it relates to Federal Orders. And I will tell you, some of the producers in the Southeast have a lot of concern about the Orders and there is talk of suspending the Orders in our area. I am wondering, given the original purpose of the Order System to ensure we all have adequate access to fresh fluid milk, do you think we still need the Orders to do this today?

Mr. DAY. Well, thank you for that question. We are not seeking any changes in legislation at this time. We are trying to do all of the changes administratively. With regard to the Southeast, we have been working proactively with the Southeast dairy industry to find consensus among all the different participants, in order to see how the Orders can achieve their purposes of improving the situation in the Southeast. We have recently met with them. They have found some consensus and they have sent a proposal to us which we are analyzing as we speak. So in answer to the question, are the Orders still useful to them, I believe they are and I believe this proposal will help address the situation, both in the short and medium term, in the Southeast.

Mr. HAYES. Thank you, Mr. Chairman. I yield back.

Mr. BOSWELL. Thank you, Mr. Hayes. At this time, we would like to recognize, for 5 minutes, the lady from New York, Mrs. Gillibrand.

OPENING STATEMENT OF HON. KIRSTEN E. GILLIBRAND, A REPRESENTATIVE IN CONGRESS FROM NEW YORK

Mrs. GILLIBRAND. Good morning. Thank you for coming and thank you for giving us your time and testimony. I come from upstate New York and in upstate New York, our dairy farms are really in a crisis right now. With high feed costs, with high fuel costs and low milk prices, they are really having a very difficult time making a living. And most of them, because of the low milk prices last summer at $12 per hundredweight, are heavily in debt, hundreds of thousands of dollars in debt, and their big concern is that they are not going to be able to recover because of that high level of debt. Even if the prices do go to a proper level, they will not be able to pay off all of their debt and continue to sustain their farm.

So I am very concerned about the issue that my colleague brought up, about this misreporting of pricing, and I would like you to address a little more fully how you are going to review the price reporting procedures and make them more effective. And I want to just read something from *The Milkweed*, which is a popular publication for our dairy farmers. It says, "Failure by USDA to input accurate nonfat dry milk commodity prices has caused a systemic failure in the Federal Milk Order Pricing System. Because of too low milk powder survey prices, USDA's complicated milk pricing system has low-balled dairy farmers' milk prices during the past half year. During that time, USDA's Class IV prices have been un-

dervalued, because prices for nonfat dry milk have been misreported to USDA's weekly dairy commodity price survey."

I would like you to address what you are doing now, but also what you didn't address, what is to stop more underreporting in the future and how you are going to deal with this on a long-term basis. For some of our dairy farmers, they have analyzed that this has cost them as much as $3 per hundredweight in the prices they received because of this fraudulent activity.

Mr. BOSECKER. Thank you, Congresswoman. As you mentioned, the program is complex. There are a number of instructions to our reporters for what they are to include and what they are to exclude. One of the things they are to exclude is a long-term fixed price contract and that is specified on each questionnaire, weekly. And as I mentioned, we visit them annually, in person, to talk to the officials who fill out the reports and we go over each of these items, what is to be included and excluded. However, because of the complexity, it is possible that misreporting can occur. We take it very seriously, the potential for misreporting, and that is why we visit with the plants and periodically go over what they should do. The plant in question that we revisited very quickly, cooperated with us to provide the data and now we are again visiting all the plants within the next 45 days to make sure, number one, that they understanding going forward and to try to find out what the impact might have been in the past. There are a lot of numbers that are floating around out there. We want to do our best to try to find out just how much that might be.

Mrs. GILLIBRAND. And what will you do going forward? Once you figure out what the mistake was, what will you do going forward to prevent this from happening again?

Mr. BOSECKER. NASS is working cooperatively with our compatriots in the AMS to define a rule for auditing of the plants, and I would let Administrator Day address that.

Mr. DAY. Right. We are moving rulemaking through the Department. I believe we are expediting that to get it out as quickly, by the end of this week, over to other members of the U.S. Government that review rulemakings that we produce. And they are sensitive as well to the importance of this issue, given the misreporting that has occurred. And once that rule is in place, the Agricultural Marketing Service will have auditing power to go in and look at the pricing to ensure that handlers are giving NASS accurate pricing data.

Mrs. GILLIBRAND. Thank you.

Mr. BOSWELL. Thank you and we will have a second round. Okay. The chair would like to recognize Mr. Goodlatte for any questions he might have.

Mr. GOODLATTE. Thank you, Mr. Chairman. Administrator Day and Administrator Bosecker and Deputy Administrator Coale, welcome. Mr. Krug, we are very pleased to have your testimony, too, as I alluded to in my opening remarks. Let me first say that I appreciate the efforts that the Department has made to work with the dairy industry in the Southeast to address some of the unique problems that we are facing. I know that you are considering some proposals. You referenced that in response to the questions from Mr. Hayes. Those proposals were just submitted last month. I won-

der if you could tell us what the current status of that action is? What is the process? When might we expect to have some decisions made about the proposals that were submitted?

Mr. DAY. We received the proposal on April 9, I believe. Is that right, Dana? And we are analyzing those proposals right now and from that we will announce a hearing on the proposals, once we finish the analysis that it warrants a hearing. And so from that we will go into in the rulemaking process and given that this has been a significant concern in the Southeast, I would think we would go under this under an emergency rulemaking to implement it as quickly as possible. And we will use those procedures that we have dictated or discussed early before, to make it move as smoothly as possible and as quickly as possible.

Mr. GOODLATTE. Thank you. Any idea of when you might announce such a hearing?

Mr. DAY. I would assume in the very near future.

Mr. GOODLATTE. Okay. Regarding the broader issue that I had mentioned in my opening remarks, and Mr. Hayes also mentioned, of Marketing Order reform, in a full committee hearing just earlier this year, on February 14, I asked Secretary Johanns about the possibility of legislative proposals from the USDA to improve the Order amendment process. The Secretary's answer focused more on the mandates of the Administrative Procedure Act than the Agricultural Marketing Agreement Act. Having had an opportunity for further review, I am wondering, you said in response to Mr. Hayes, that you are not looking for any legislative proposals. This time you were looking for some internal administrative changes and that is good. I am glad you are doing that. But as I indicated, I am not sure that is going to be enough and so I am wondering if the USDA might at least be able to clarify the record regarding what can be fixed administratively and what requires legislative attention, so that if the Members of this Subcommittee want to work with the Chairman of the Subcommittee and the Chairman of the full committee on a legislative fix what things are beyond your purview, and what things you can and are attempting to address administratively.

Mr. DAY. Well, administratively we have done some of the things that I have discussed already before and we are working to develop supplemental rules of practice through informal rulemaking that will define the parameters of everything from submitting briefs to everything that the industry has to put together for the formal rulemaking process. The only legislative thing, as I understand, that you could do is somehow amend the Act, and that would be the Administrative Procedure Act, that governs formal rulemaking, which is fairly controversial and I know it would have lots of folks with lots of different opinions on that. But if you were able to do something like that, it could potentially speed up the process.

Mr. GOODLATTE. So it is your opinion that amendments to the Agricultural Marketing Agreement Act would not be helpful?

Mr. DAY. At this time, I don't think they would be helpful. I think what would be useful is that, in this commission that folks are discussing to put together, if they could take a look at potentially what exists within both administrative purviews as well as

legislative purviews for potential fixes, we could certainly consider further what could be done both legislatively and administratively.

Mr. GOODLATTE. Well, as we move forward in this Subcommittee, I hope that you will make a further examination of that and advise us of any things that you identify that are within the jurisdiction of this Committee that could be done to legislatively streamline the decision making process, because it is one that I know that the Department has been very dedicated in acting on in this particular case, which I am very familiar with, but one that nonetheless requires such a lengthy process, that by the time a decision is made, marketing conditions have often changed yet again. And in terms of the concern addressed by the gentlewoman from New York, dairy farmers across the country are very much squeezed right now by, well, they are not the lowest prices, they are relatively low prices and that is juxtaposed against high input costs that require a quick response in terms of marketing Orders. Thank you, Mr. Chairman.

Mr. DAY. Yes, we would be happy to look at that and see what we could come up with.

Mr. GOODLATTE. Thank you, Mr. Chairman.

Mr. BOSWELL. Thank you, Mr. Goodlatte. The chair at this time would recognize the gentleman from Indiana, Mr. Donnelly. He stepped out. I guess we are going to move on then to the good doctor from Wisconsin, Dr. Kagen.

OPENING STATEMENT OF HON. STEVE KAGEN, A REPRESENTATIVE IN CONGRESS FROM WISCONSIN

Mr. KAGEN. Thank you, Mr. Chairman. Mr. Day, what is the minimum time that AMS could issue a decision on a Federal Marketing Order?

Mr. DAY. The minimum time? Well, it depends. On an emergency basis, we have done it within about 3 months, but in most cases, we are trying to focus to under a year on an emergency basis; about 14 months, on a normal rulemaking procedure.

Mr. KAGEN. Well, if you were an emergency room physician and you had to wait a period of time, as you suggest, the patient wouldn't make it. So I am sure you are interested in squeezing that time down even more. What are you doing in that regard to hasten it?

Mr. DAY. Well, we have discussed a little bit earlier today some of the procedures that we are putting in place to bring it down for the normal cases from 2 years to about a year or 14 months and those include everything from bringing the industry together beforehand to having a pre-hearing meeting to working within the administrative procedures that we have outlined to develop supplemental rules of practice through internal rulemaking and then finally by procuring better or the best court reporters we can in order to get—when that evidence comes through, to get it done as quickly as possibly so we can then submit it out to the public so that they can view and comment on it.

Mr. KAGEN. Does the USDA have any plans to address the role that whey plays in Class III milk prices?

Mr. DAY. That is under consideration.

Mr. KAGEN. Can you elaborate?

Mr. DAY. Well, it is under current rulemaking, so I am afraid I am, by law, not able to elaborate on that.

Mr. KAGEN. I wouldn't want you to violate any laws. I will yield back my time.

Mr. BOSWELL. Thank you. The chair at this time would recognize the gentleman from Michigan, I have it straight, Mr. Walberg.

OPENING STATEMENT OF HON. TIM WALBERG, A REPRESENTATIVE IN CONGRESS FROM MICHIGAN

Mr. WALBERG. Thank you, Mr. Chairman. I had the privilege of having seven agricultural listening sessions 2 weeks ago for in-district work period and frankly, the dairy concerns were probably number one of all of the testimony, information, and concerns that were addressed, so I appreciate the opportunity to ask some questions today. And Mr. Krug, thank you for joining us here this morning. Let me ask you. Recognizing the inherent differences in the scope of the Federal and California milk marketing programs, I assume there are aspects of the California system that simply would not work for the Federal system. You have confirmed that to some degree already. Can you offer some perspective on what you would think will or will not work in the Federal system?

Mr. KRUG. Well, one major difference of our two systems is the amount of testimony submitted in the record and that probably comes about because cross-examination is not allowed in our hearing process of the witnesses, except questioning by the panel from the Department of Agriculture. Questions can be submitted to the panel to be asked. The audience can submit those questions. But anyway, I know that the records that get generated in the Federal process are huge and then it takes a long time for the analysts to go through the record. So I think that is partly because you have 10 Orders and so many geographic areas and the regional issues that are out there; so that makes the issue much more complex than we probably handle in one state.

Mr. WALBERG. Of course, you are a diverse agricultural state. Michigan has the, I guess, distinction of being second only to California in the diversity of its agriculture. But you are saying the administrative process is much more broad and cumbersome here?

Mr. KRUG. Well, the rules are set up for a more exhaustive process under the Federal Order System. We have very tight timeframes and the hearings generally don't go longer than 2 days. And when you have a 2-day record, it is easier to do that analysis in a shorter period of time.

Mr. WALBERG. Okay, thank you. Administrator Day, let me ask you. Within the context of Doha, the United States has proposed cutting amber box by 60 percent; and 83 percent for the EU. To put a dollar figure on this, the United States proposed to reduce its domestic support from the current level of approximately $20 billion to around $8 billion. Combining MILC and the price support program, dairy accounts for more than $5 billion. Do you envision the Administration proposing a reduction in the level of the domestic support to the dairy sector?

Mr. DAY. That is a very good question, Mr. Walberg. I notice from this hearing that I need new glasses because it is very difficult to read the names. But I am not responsible for the Doha dis-

cussions and the debates and so I will read to you what I believe would be the Secretary's response to that, to a similar question that he received. The proposal that we have for the farm bill recognizes that milk prices have been well above support prices in recent years and the trend is expected to continue. Therefore our proposal focused on a safety net for dairy farmers to address the variability in milk prices. We maintain the MILC program, but propose that the MILC payments are consistent with our other counter-cyclical safety net programs. The payment rate would be phased down over the life of the program and payments would be based on 85 percent of historical milk marketings over the 2004 through 2006 period. The proposals are also good WTO policy, because payments that are based on historical production are less trade-distorting. Now, I know that doesn't answer your question, if we were going to reduce that support based on what the Doha deal is, but——

Mr. WALBERG. Well, it sounds like a reduction.

Mr. DAY. Well, it is a small reduction, but one that still maintains that safety net.

Mr. WALBERG. Okay, thank you. I appreciate that and I yield back.

Mr. BOSWELL. Thank you. At this time, the chair recognizes the gentleman from Texas, Mr. Conaway.

OPENING STATEMENT OF HON. K. MICHAEL CONAWAY, A REPRESENTATIVE IN CONGRESS FROM TEXAS

Mr. CONAWAY. Thank you, Mr. Chairman. I appreciate that. And based on your opening statement, I am even less qualified to ask questions this morning than you are, because I don't have a lot of dairy in my district, but I do have a couple of points that caught me during the testimony. One, our colleague from New York used the word fraud with respect to the reporting error. Mr. Bosecker, is it fraud, mistakes, honest errors, or what?

Mr. BOSECKER. At this point, we cannot answer for sure on that question. We are going back to the plants and I must say that when we did re-contact a plant in question, they were very forthcoming.

Mr. CONAWAY. Do they have a turnover of personnel? Is there somebody new preparing the reports? I suspect these reports are basically the same every period. Do they have somebody new doing it and are they just misunderstood?

Mr. BOSECKER. That is not my understanding. I don't have any knowledge that there was someone new.

Mr. CONAWAY. So the same person made a change in it?

Mr. BOSECKER. However, there could be changes and what is entering their pricing schemes come in and out and something may not have been in there for a long time and showed up. There are a number of factors that are possible.

Mr. CONAWAY. Okay. Mr. Day, you used the word emergency and you also used the word urgent. Let me ask this other question first. Something that struck me that was really odd is that USDA has a problem with court reporters. Court reporting or hearing reporting is done everywhere and you are the first person who has come

to us, or at any place I have ever been, who said you had a problem getting qualified, competent reporters. What did you just tell us?

Mr. DAY. That is a very good question. We used to have a practice of getting the best value, in other words, the least expensive court reporters that weren't as good as getting a higher-paid, higher-skilled court reporter, and so we have moved to paying a higher premium to get folks that will be able to get the court reporting done in a quick and efficient way.

Mr. CONAWAY. How long did it take you to come to the conclusion that your reporting wasn't being done timely? I mean, how long have you had this problem?

Mr. DAY. We moved to it in 2005, so it was 2 years ago and I don't know——

Mr. CONAWAY. Yes, before 2005, you weren't using court reporters?

Mr. DAY. I am going to turn it over to the person who actually made a lot of these changes and has been working hard to streamline the system, Deputy Administrator Coale.

Ms. COALE. Thank you. Prior to 2005, we were required, under the contracting regulations or rules in place at USDA, to use a USDA-contracted court reporting service and this was a service that USDA contracted for. We used them in one particular hearing and the industry can attest to this. It took us over 3 months to get a hearing transcript from the proceeding and ultimately, when we did get the transcript, it was in such poor shape that we weren't able to——

Mr. CONAWAY. Okay. Given my limited time, Ms. Coale, is this the only the only problem you had?

Ms. COALE. No, prior to that. Once we started doing the best service, since 2005, we have had good delivery on our——

Mr. CONAWAY. So Mr. Day, the comment about reporting is a dated issue?

Mr. DAY. Correct.

Mr. CONAWAY. I am not sure how it is helpful to us this morning. Help me understand what emergency and urgent mean, in the context of a 14-month rulemaking process. What denotes emergency that takes 14 months to fix? I have a little different context on emergency, kind of like what my colleague from Wisconsin was talking about.

Mr. DAY. Well, it is not an emergency, it is more the marketing conditions which have changed and the industry comes to us and they request emergency proceedings so that we can expedite the rulemaking and so it doesn't take 2 years, so that we can get it done within a year.

Mr. CONAWAY. I am sure the witnesses that will follow will be very relieved that we have trimmed it off from 24 months to 14 months. Again, I am not really qualified to be grilling you like this, Mr. Day, but what I have heard from you this morning is an awful lot of mumbo-jumbo.

Mr. DAY. Well, I am sorry it sounds like mumbo-jumbo. It sounded like mumbo-jumbo when I first had to deal with it myself, sir, I can assure you. But the way that it is structured is so that there is a maximum public participation and transparency in the Federal rulemaking process, through the Administrative Procedure Act, so

that all participants have the ability to present their case and also to cross-examine the case of those who are putting the proposal out there. And so it becomes this complex body of evidence—excuse me—that is reviewed by all participants in the industry and then they produce comments on it. So it is not that it is mumbo-jumbo so much that it is a complex legal proceeding that is structured now for maximum public participation that can stand up to litigation, which it frequently comes under.

Mr. CONAWAY. Okay. Thank you, Mr. Chairman.

Mr. BOSWELL. Thank you, Mr. Conaway. And that is our first round. By the way, it was an interesting question. Mr. Day, we could find some court reporters. I could direct you to a little college that is turning out some good ones, but you would have to ask me that. I couldn't volunteer that. A question I would have, Mr. Day: Each decision made in a Federal Order is voted on by the producers in that group or Order, but they are not necessarily given the right to vote, the individuals. The Order allows for cooperatives to block-vote their membership. Does this create any concern to you for what the producers themselves might feel as far as you collecting information? Do you feel they should have the right to be able to vote on decisions that affect their business?

Mr. DAY. That is an excellent question. Historically, since these cooperatives are composed of boards that are made up of their producers, we feel that that issue of the producers not having a say in the vote isn't actually a problem. They have the right to go through their cooperative process to tell their board what——

Mr. BOSWELL. Well, I understand that, but I thought we should discuss it a little bit. I have been a lifetime supporter of co-ops. I have chaired a co-op board for many years and times, but it is so volatile, this business of milk marketing, that I just wonder if there have been times that you felt like you maybe ought to have reached out to the individual producers themselves, and that was the reason for the question. What would AMS need to add to its current budget and staffing levels to provide the level of data collection that is ultimately now provided by CDFA?

Mr. DAY. The level of the data collection?

Mr. BOSWELL. Yes. And auditing.

Mr. DAY. I think we will have to get back to you on that.

Mr. BOSWELL. Okay, would you do that?

Mr. DAY. Yes.

Mr. BOSWELL. We are delving into budget matters as well. And I had another question for you, Mr. Krug, but I think you have pretty well answered it, on the timeliness of getting your decisions out, so I thank you for that. At this time, I would recognize Mr. Hayes.

Mr. HAYES. No questions.

Mr. BOSWELL. No questions. Mrs. Gillibrand?

Mrs. GILLIBRAND. Thank you, Mr. Chairman. I would like you to take some time. I have looked at the USDA's website and you have discussion questions and answers on Federal Milk Marketing Orders and the question of today is how are specific price levels determined? And your answer on the website reasonably reflects economic conditions affecting the supply and demand for milk, such as feed prices, assure a level of farm income adequate to maintain

productive capacity sufficient to meet anticipated and future needs, be in the public interest, and to assure adequate supply. I would like you to address these four principles, particularly, has the milk pricing been reflecting the cost of feed? With the interest in corn-based ethanol, feed prices have skyrocketed and when I look in these industry magazines, they recommend that dairy farmers lock in feed prices now because those prices are going to continue to go up.

So I want you to address that, how you look at the feed prices. I also want you to look and explain to me how you assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs, because from what I have been able to understand over the past several months and over the past year, that milk pricing hasn't reflected the adequate level of farm income and that our farms are going out of business. In the Northeast and in New York State alone, over 30 percent of our dairy farms have gone out of business over the last several years and it is really impacting our economy, our quality of life, the level of wholesome foods available, so please address these issues.

Mr. DAY. Well, thank you for that question, Mrs. Gillibrand. I understand full well the concern that many dairy farmers, and many beef and poultry farmers as well, are facing right now with the higher cost of feed. I just want to reiterate that the Marketing Order Program is not a price support program. What we do is guarantee a minimum price, a blend price based on what is actually the supply and demand factors that NASS reports on the price of milk and butter and cheese. And so what we do is we add, for dairy farmers, the price is less for Class III and IV than it is for I and II, they get that blend price no matter what. And many in the industry have tried to come to us in the last several weeks, because of the increasing price of corn, to say you need to use the Marketing Orders to fix that, but again, we are not a price support system.

Mrs. GILLIBRAND. Let me interrupt you for a moment. Is the answer on your website, then, incorrect?

Mr. DAY. What was the answer, again?

Mrs. GILLIBRAND. It says, how are specific price levels determined? Point A, reasonably reflect economic conditions affecting the supply and demand for milk, such as the price of feeds.

Mr. DAY. That is true. It is in there and it is part of what is the make allowance, which becomes the price of manufacturing of Class III and IV product, and then the price of Class I and II product is a differential that is on top of that, but those are economic factors that are under consideration in that formula. And recently there was a court case in January that upheld that decision. Or in February. Excuse me.

Mrs. GILLIBRAND. So please address the second point. I understand it is not a price support system, but if these are how the prices are determined, are you actually using these four components in your price system? I mean are you, in fact, assuring a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs?

Mr. DAY. One of the issues about that, that is a good question because at the end of the day, the production of the product and

the amount of supply and demand is going to determine what the price of that product is. And if the price of the product goes into a point where the farmers, such as the ones you are discussing, are not able to pay their loans, then the statement on the website is not exactly accurate, because farmers react in all sectors, in dairy, in corn, in whatever, to the price in the marketplace. As that price goes up, as you saw from the recent corn planting intentions, more people are going to move into that commodity and so we have these unfortunate swings that occur. But what this program does is at least guarantee a minimum price for those producers and some of them obviously don't make it and we are distressed by that, but that happens in all segments of agriculture, unfortunately.

Mrs. GILLIBRAND. I only have 17 seconds, but in the last item it says be in the public interest. How do you, as the USDA, define the public interest? Is survivability of dairy part of the public interest?

Mr. DAY. Well, certainly and part of the public interest is also to have an adequate supply of fluid milk, and so through the Marketing Order Program, we are able to do that, both by guaranteeing a minimum price as well as by balancing it with the blend price so that you don't have the potential chaotic conditions that might occur when processors and farmers, or farmers are competing to get a different price from the processors.

Mrs. GILLIBRAND. Thank you, Mr. Chairman. Thank you for your testimony.

Mr. BOSWELL. Thank you. The chair recognizes the gentleman from Virginia, Mr. Goodlatte.

Mr. GOODLATTE. Thank you, Mr. Chairman. Let me follow up on the question from Mrs. Gillibrand. Administrator Day, in response to my questions, you said the Administration wasn't looking to offer any legislative solutions and you pointed to the Administrative Procedure Act as being something that is very controversial and making changes to that could be quite difficult and I certainly understand that. That is a government-wide administrative process, is it not?

Mr. DAY. Yes.

Mr. GOODLATTE. That it governs actions taken by the Environmental Protection Agency, actions of all kinds of environmental and labor regulations and so on. What you are attempting to do, and I appreciate very much the sincerity of what you have had to say and what is said on your website about trying to be responsive to the needs of dairy farmers. What you are trying to do is react quickly to changing market conditions. That is a very different type of thing than some of the types of regulations that are issued under the Administrative Procedure Act, is it not?

Mr. DAY. Yes, it is, sir.

Mr. GOODLATTE. Well, one of the things that I understand has been an ongoing discussion is whether or not dairy policy, changes in dairy policy, like the transportation issue that we have been concerned about in the Southeast and other issues related to responding to things like the make Order and how farmers address the fact that their grain prices go up a lot more quickly in a year, which was what you said you tried to get emergency responses taken care of. Wouldn't it be better to think outside the box here and examine

whether or not there ought not to be a better way to make these decisions more quickly than under the Administrative Procedure Act? That would certainly be under the jurisdiction of this Committee, to look at changes in the Agricultural Marketing Agreement Act that would allow us to come up with a new way of allowing you to act more quickly to make some of these decisions.

Mr. DAY. Oh, we would certainly be open to consideration of any new ideas.

Mr. GOODLATTE. Well, we are looking for ways to empower you to be able to act more quickly. Obviously taking into account all the complexities that go into dairy policy, and we certainly understand that, but at the same time recognizing that when a farmer is hung out there with high grain prices, high energy prices, they need changes pretty quickly as has been correctly noted, that is not how you would respond to other types of emergencies when people are hurting pretty badly. So I hope that we can expand these discussions and include the Chairman and his staff and others to look at whether there isn't a creative way to insert into this farm bill some new process that you could follow that would allow you to act more promptly, and to address the things that have been noted by Mr. Krug, that actually are correct if you start from the premise that we are hamstrung by the Administrative Procedure Act. Maybe there is a way to put you on to a different process than to simply say you have got to follow all of those procedures, because that is what is done with all other regulations under the Federal Government.

Mr. DAY. Right.

Mr. GOODLATTE. And I think there are other sectors of our economy that react much more quickly to market forces and are not bound by the process of the Administrative Procedure Act and we certainly wouldn't expect, for example, the Federal Reserve to respond to interest rates in that fashion and to say we will get back to you in a year about whether we need to raise or lower interest rates.

Mr. DAY. And we look forward to working with you on that, sir.

Mr. GOODLATTE. I thank you and I thank the Chairman.

Mr. BOSWELL. The chair appreciates, Mr. Goodlatte, your comments and let us associate ourselves, the whole committee, with those suggestions. Thank you very much. And we would like to work with you and expedite, if at all possible, the things we have been discussing about. At this time, the chair would recognize the gentleman from Wisconsin, Dr. Kagen.

Mr. KAGEN. Thank you, Mr. Chairman. I have to apologize to you for being late, so I didn't get to hear Dana Coale speak, but I would like to ask you, since the Agricultural Marketing Agreement Act of 1937 was enacted and subsequently amended, "to establish and maintain such orderly marketing conditions as will provide, in the interest of producers and consumers, an orderly flow of supply to avoid unreasonable fluctuations in supplies and prices." Can you remind me of two things that you are most proud of in doing, in your position, to see that that Act is carried out? Dana.

Ms. COALE. Thank you, sir. I have been in the position for the last 2½ years and I think one perfect example of how we were able to react to marketing conditions would have occurred when the

hurricanes hit in the Southeast region of the United States in 2004. During that time, there were several hurricanes and what we saw was a huge disruption to the marketing of milk in that region. The Department was able to work very closely with the industry and we were able to identify provisions within the Orders that could be changed to help ensure that fluid milk was being obtained by the marketplace for consumers, and that the dairy industry was not having to incur unnecessary transportation costs to meet those needs.

Mr. KAGEN. So under extreme emergencies, you can respond rather quickly?

Ms. COALE. Absolutely. One of the unique things that made that situation work very effectively for everyone was the fact that there was nearly complete consensus in the industry, both on the processing side and the producer side, and I think if you were to examine the industry, that that is a very rare occurrence, for everyone to have a consensus. But everybody identified the need and we were able to move quickly on that. I think that is an important thing for the industry as a whole. To move forward and to move more rapidly, we need to be able to build consensus within the industry on issues that can be addressed within the Federal Order program, and I think that will go a great length in helping to expedite any processes and any proceedings that come before us. Part of the challenges that we face is, when we hold a hearing, there are very differing opinions and these differing opinions occur not only between processors and producers, but they occur between producers themselves. It makes it very challenging for the Department to look at all sides of the issue and determine what is truly an appropriate response and appropriate action that is going to ensure the efficient marketing of milk for the industry.

Mr. KAGEN. And what can you identify for us this morning as perhaps your most glaring need to improve upon?

Ms. COALE. The most glaring need to improve upon, there are probably several issues that could be addressed on that. I think if we were to look at particular proceedings, I could identify a couple that I would have desired that they would have moved more quickly. But part of that is a failure for possibly USDA and the industry to discuss the issue prior to getting into restrictions by the rulemaking process, to identify things that would be needed for the evidentiary record of the proceeding for the Department to be able to make a decision. Absent having that information on the record, it becomes very difficult to make a decision. Part of the process that we implemented with the current Class III/IV proceeding was to put in place a pre-hearing workshop and this was designed clearly after the California system. When we talked with them, we made modifications to it to fit our current program. But what that was, it was an attempt for the Department and the industry to have a thorough conversation before anybody who was interested in participating, to discuss the issues so that everybody understood what the proposals were that were being considered and what information would be needed by the Department to be able to make a decision based on the hearing as we are going through it.

Mr. KAGEN. Thank you very much. I yield back.

Mr. BOSWELL. Thank you, Dr. Kagen. Mr. Walberg is recognized for 5 minutes.

Mr. WALBERG. Thank you, Mr. Chairman. Just to take another shot at the rulemaking process and follow up a bit with what Mr. Goodlatte addressed, if indeed, in the Agricultural Marketing Agreement Act, the formal rulemaking process is required. If we were to go to an informal rulemaking process, would that speed it up, the whole process of making the rules, and would it be valuable enough to proceed in that direction?

Mr. DAY. Well, I think it is certainly something that we can discuss as we continue to have a discussion related to how we can speed up this process. I think the quick answer is that moving to informal rulemaking would not necessarily make it any faster because, as Dana just articulated very well, there is often a lot of division about a given proposal. The good thing about formal rulemaking and the process as it is today, is that it raises all of that discussion into an evidentiary record of the proceeding that can then be decided upon and analyzed and stand up in a court of law, because often these cases are, before they even become final rules, there is an injunction of some kind.

Mr. WALBERG. Well, it just seems that though there is disagreement out there and significant, that some way, somehow, that there can be a coming together and present those diverse opinions and even hopefully come to agreement that we have to coalesce around an issue and make a decision to bring it before the rulemaking process and ultimately the process could move more quickly in a formal proceeding. I don't necessarily understand why we have to major on the disagreements to the point that we just extend the disagreement talk over and over and over.

Mr. DAY. Yes, I understand and I think what we have tried to do in the Southeast is something where we worked together with the industry to bring everyone together so that before we move into a hearing process, that we built that consensus, and I think we will have to see how that proceeding moves forward, but I think that will be evidence of where the Department has actually gone out and been proactive to address a certain economic condition to build that industry consensus before we get into a proceeding and hopefully that will make it a lot smoother and a lot faster and a lot less contentious.

Mr. WALBERG. Well, hopefully that would be the case. I know the producers don't have that luxury in most cases. In the process of going through this, first, the farm bill myself, I have been doing 101 training and educating and mentoring the process and reading reports and things like that. It was interesting to read some of your reports, the USDA, and one such indicated that, with the milk program and the price support program, they seem to be contradicting each other, in some ways going in the opposite direction, and indicating that it has a net negative impact upon the producer prices. And so my question is, if their combined effect is to hurt producers, why has the Administration proposed to continue these two programs beyond the 2007 Farm Bill?

Mr. DAY. I am not aware of the study or the comments where farmers have said that they hurt producers. I know that when the Secretary conducted his farm bill hearings around the country, a

lot of dairy farmers came to talk to him and some of them talked about MILC, some about the dairy support program, some talked about the speed of Federal Milk Marketing Orders, but it seemed pretty uniform, especially when he met with smaller farmers, that there was a lot of support for the MILC and for the Milk Price Support Program, and because of that, the Administration moved forward to continue those programs, sir.

Mr. WALBERG. I mean, this was just coming from your reports indicated that the simultaneous operation of the milk program and the price support program has a net negative impact on producer prices, and so I am just responding to that statement.

Mr. DAY. Yes.

Mr. WALBERG. I am wondering why, if that be the case, the Administration goes forward and pushes the continuation of these programs, the two programs, that seems to, according to your reports, have a negative impact on producer prices.

Mr. DAY. Well, I will have to look at those reports in question, but I believe the farmers around the country see those two programs as providing that safety net for them in the event that production increases so much that prices fall dramatically.

Mr. WALBERG. Okay. Well, I appreciate you checking on the report, then, and finding out why the Department says that it is a problem and when the producers are saying that it isn't a problem, what you are telling me today. So I see my time is up. Thank you.

Mr. BOSWELL. Thank you. Well, I think that pretty much brings us to closure. Anybody have any last question they want to ask to this panel? Mrs. Gillibrand, please go ahead.

Mrs. GILLIBRAND. Just one question. My background is as an attorney and I did a lot of antitrust law and so that is the framework that I look at for this new industry that I am now trying to represent, the dairy farmers of upstate New York, and I have a question about DairyAmerica. It is a marketing agency of cooperatives and they understand that they control roughly 80 to 85 percent of all nonfat dry milk produced in the country. Have you guys ever analyzed any antitrust issues or concerns about how this kind of organization could impact the pricing?

Mr. DAY. I think that would be the Department of Justice that would look into that. I don't know. From our perspective at AMS, we haven't done anything like that.

Mrs. GILLIBRAND. Is it relevant at all to your inquiry if information comes only from one entity?

Mr. DAY. Could you repeat that question?

Mrs. GILLIBRAND. Is it relevant to your analysis at all, of the source of the information for pricing?

Mr. DAY. I think that is a question for you, Ron.

Mr. BOSECKER. Certainly since all of our data are weighted by the amount of the product that is actually sold, then the size of the firm would very definitely impact the overall average price of the product.

Mrs. GILLIBRAND. Thank you.

Mr. BOSWELL. Okay. Well, thank you very much. We appreciate your testimony and your participation and we will excuse you at this time and ask the second panel, if they would join us at the table. Thank you very much. And so just by introduction, we have

Mr. Chris Kraft, a Board Member of Dairy Farmers of America, from Fort Morgan, Colorado. Welcome. Mr. Dennis Donohue, General Manager, Manitowoc Milk Producers Cooperative, from Manitowoc, Wisconsin. Am I saying it right, Manitowoc? Mr. Billy French, Dairy Farmer, testifying on behalf of Virginia State Dairymen's Association, from Maurertown, Virginia. Did you by chance know an old colleague of mine that lived just up the hill in Maurertown, on the hill, named Roy Calvert? We served in the Army together and I am aware that he is recently deceased and if you happen to see Jean, please give her my regards. Thank you. I saw him just a few days before he passed. He was a great soldier. And Mr. Eric Ooms, a Dairy Farmer, Old Chatham, New York, and from Mrs. Gillibrand's district. I was just informed. That is good and we welcome you. Mr. Ed Gallagher, Vice President, Economics and Risk Management, for Dairylea Cooperative, Inc. from Syracuse, New York. So with that, Mr. Kraft, please begin at this time. Thank you very much.

STATEMENT OF CHRIS KRAFT, OWNER, DAIRY FARM; MEMBER, DAIRY FARMERS OF AMERICA, INC. (DFA)

Mr. KRAFT. Good morning. I am Chris Kraft and my wife, Mary, and I own and operate two dairy farms in the Fort Morgan, Colorado area.

The U.S. dairy marketplace is composed of approximately 62,000 commercial dairy farms, 400 fluid milk plants owned by perhaps as few as 75 entities. Ten retail companies that, according to industry publication *Supermarket News*, account for 68.4 percent of all grocery sales, have a firm grip on the retail grocery market. Clearly, dairy farmers are not in a position of equal bargaining power and Federal Orders are the key in maintaining a more level playing field for dairy farmers. Orders provide the marketing framework for dairy farmers. They announce and enforce minimum prices, provide common terms of trade for milk marketing, and ensure timely and accurate payment for milk sold by farmers, and audit milk sales to help farmers capture their share of the consumer dollars. Without them, producer incomes would be worse and we feel consumers would be ill served.

Because the dairy industry and markets evolve, Orders must be open to change. While the industry appreciates the fact that the change process should be open, transparent and deliberate, the extreme slowness of the process leads many to become disgruntled and discouraged, leading to frequent complaints. I am concerned that if the Federal Order hearing process is not improved, producers will succumb to the constant rhetoric about the negatives of Orders and throw the baby out with the bath water.

In my testimony today, I will outline three issues involving the Federal Order System and hearing process. They include: (1) changes needed to streamline the Order hearing and decision procedure and the data necessary to hold a hearing; (2) the inadequacy of staffing levels at key positions within the Order System; and (3) a few key comparisons between the Federal Order System and the California order system.

The industry is very concerned about the length of time that it takes to make changes in the provisions of a Federal Order. There

are no mandated time constraints to institute a sense of urgency to the process. Our cooperative has had several business lines that are currently stymied in their planning and marketing operations because an Order decision that affects them has not been announced in a reasonable time. We feel that USDA does a good job of moving decisions through the process, so long as the decision itself remains inside the dairy program staff area. However, once they travel up the chain of command and back down with any revisions needing multiple briefings, reviews and rewrites, the process often stalls. It would be helpful if USDA revised its administrative procedures rules to institute guidelines and time tables. For example, if all the decisions were required to be published to the dairy industry within a certain time period, possibly a hundred days after a hearing, USDA would have to streamline the process. The Committee should get a clear answer from Mr. Day this morning, whether or not USDA believes it can promptly effect this type of rule change in its own administrative procedures process, or whether it requires a Congressional action. Either the Federal Order System should be exempted from certain other review processes or given the authority to certify that a particular decision meets the intended nondairy rules or requirements.

Mr. Gallagher outlines several examples of procedural changes specific to the hearing process, including a formal review of the process by a third party that would report back to this Committee. We very much endorse this review concept and urge the Committee to adopt it. More specifically, we would be willing to participate in the process if asked. We would appreciate the Committee requesting a report from Mr. Day, within 60 days, as to what USDA intends to do to speed up the hearing process and follow the progress reports on how these steps are being completed. A second issue related to the hearing process that needs attention, because the dairy industry, by itself, cannot do an adequate job in this area, is collecting data relative to the product formula price hearings.

Milk is a perishable product. As a dairy farmer, I have to sell my product every day. I simply can't put milk in an elevator and wait to bargain for a better price tomorrow. Our industry requires a system that establishes prices in a reasonable time and is responsive to market conditions. Our current system uses storable products to set prices on perishable milk. This mechanism is termed product price formula pricing. It is a reasonable way to price milk, but to do this the industry needs a good price discovery, milk component and plant yield data and the cost to convert milk into various products. Everyone in the industry has a vested interest in the numbers that must be generated for the price formulae so each of our individual company data represented at the hearings is biased. We need USDA to do the product yield research and cost surveys and post the data for industry to use. The process of sorting through all of this proprietary data at a hearing is difficult at best. Each side has its own data set and reports as it chooses, but always with an eye to their own interest.

I think I have gone over my time and I think that I will conclude right here. There are some other suggestions that we have and I thank you for your time.

[The prepared statement of Mr. Boswell appears at the conclusion of the hearing:]

Mr. BOSWELL. Thank you. The chair would recognize Mr. Donohue for 5 minutes.

STATEMENT OF DENNIS DONOHUE, GENERAL MANAGER, MANITOWOC MILK PRODUCERS COOPERATIVE; ON BEHALF OF MIDWEST DAIRY COALITION

Mr. DONOHUE. Chairman Boswell, Ranking Member Hayes and Members of the Subcommittee, thank you for the opportunity to testify today. I am Dennis Donohue, General Manager of Manitowoc Milk Producers Cooperative based in Manitowoc, Wisconsin. I offer this testimony on behalf of my cooperative as well as the Midwest Dairy Coalition.

The Federal Milk Marketing Order System has been in existence since the Agricultural Marketing Act of 1937. The number of Federal Orders has ranged from a high of 83 to the current low of 10 Orders. Even though the number of Orders has been consolidated, the rulemaking procedures are more time consuming, convoluted and costly than ever. It is no secret that Federal Orders are controversial in the upper Midwest. Many producers and cooperatives in our region believe that the structure of the Federal Orders is biased in favor of high Class I utilization regions and against regions such as ours, where the majority of the milk is used in manufacturing. Some producers and producer groups argue that Federal Orders should be eliminated all together. My cooperative does not support the elimination. However, we do share the concerns about the need for more equitable structure for the Federal Orders.

Without a doubt, some of the frustration is related to the cumbersome and uncertain procedures for making changes. First, there appear to be no clear and consistent criteria for USDA to use in determining whether a hearing request will be granted. Some proposals that seem to have little merit are given full hearings, seemingly for political reasons. This wastes time and money for taxpayers, farmers, cooperatives and processors.

Second, there are no clear and consistent criteria for how long it will take USDA to respond to a request for a hearing. For example, in September of 2005, a significant portion of the dairy industry requested an emergency hearing to adjust make allowances for manufacturing dairy products. A hearing was not held on the issue until January 24, 2006, about 4 months after the initial request. In contrast, in the case of a recent request by National Milk Producers Federation for an emergency hearing to amend Class I and II price formulae, the request was made on October 2, 2006 and a hearing was held on December 11, 2006, roughly 2 months later.

Third, the timeline for how long a hearing will be held after it has been formally announced is often too short. The process of preparing for a Federal Order hearing is very involved and complicated. The affected parties should be given adequate and consistent time to prepare. Once a hearing starts, the process is much too time consuming and costly. It is not uncommon for hearings to last a week or more for single witnesses to be on the stand for statements and cross-examined for 3 hours or more. As a result,

the price tag for legal and technical representation also runs in the tens of thousands of dollars for a single hearing subject.

After a hearing is completed, the delays before a decision is made are excessively long. In the case of the Class III and IV make allowance changes, the tentative final decision was issued on November 22, 2006, roughly 10 months after the hearing began on the subject, and this was designated an emergency hearing. Once a final decision has been announced, producers and cooperatives are also given an inadequate amount of time to vote on the referendum. When a cooperative such as mine is involved, we must discuss the subject at a board meeting before we make a decision. In some cases, the referendum deadline is so soon, that there is no time for the board to meet. Many have pointed out that the procedures used in California's state orders are much more streamlined and standardized and have suggested that the Federal Order process be modified to follow the California model. In general I agree. With the multi-regional nature of the Federal Order System, it may require slightly more time for USDA to provide full analysis.

In light of these concerns, the Federal Milk Marketing Order rulemaking procedures should be modified to: (1) Establish clear and objective criteria for determining whether a hearing request will be granted. Parties requesting a hearing should be required to show that the proposal is consistent with the requirements of the AMA Act of 1937 and there is significant support for that proposal. In the absence of those criteria, USDA should not grant the hearing. (2) Establish a clear timeline for how long USDA has to respond to a hearing request. USDA should be given a maximum of 2 or 3 weeks to grant or decline a hearing request. (3) Establish a clear timeline for how much time needs to elapse between the hearing announcement and the hearing date to give adequate time to prepare for the hearing. Once a hearing is announced by USDA, the hearing should be held 45 to 50 days later. (4) Establish clear procedures and time limits on presentation and cross-examination during the hearing process. (5) Establish time limits for how long USDA will have to issue a decision after the completion of a Federal Order hearing. USDA should have no longer than 3 months to issue a decision after a hearing is completed, perhaps even less in the case of a single Order decision. (6) Establish timelines for how long the affected parties will have to review a decision prior to the referendum deadline. Once a decision is announced, affected parties should have 45 days to vote on the referendum to ensure that cooperative boards have time to meet. By establishing clear and objective procedures for rulemaking, we all gain. It takes the guesswork out of the process, minimizes cost and ensures that no one group has an unfair advantage.

In closing, the Federal Order rulemaking procedures are one small aspect of the concerns related to the Federal Milk Marketing Order System, and even smaller still relative to the many dairy policy issues confronting the Committee as you prepare to mark up the 2007 Farm Bill. Therefore it is important to reiterate that our main dairy policy priority for the farm bill is to maintain and strengthen a credible safety net for dairy producers, as reflected by the continuation of the MILC Program and reauthorization of the

Milk Support Program, with adequate changes to make it a true safety net. Thank you for this opportunity to testify.

[The prepared statement of Mr. Donohue appears at the conclusion of the hearing:]

Mr. BOSWELL. Thank you. Chairman Peterson, did you want to make any comment at this time?

OPENING STATEMENT OF HON. COLLIN C. PETERSON, A REPRESENTATIVE IN CONGRESS FROM MINNESOTA

Mr. PETERSON. I want to thank you, Mr. Chairman and Ranking Member—Mr. Goodlatte, you are the Ranking Member today on this Subcommittee—for holding this hearing and I think it is important that people get an opportunity to learn more about this part of the dairy policy, which continues to be a problem, the unresponsiveness of the Federal System. By the time they get done making these conclusions to these Order processes, the problem they are trying to fix has gone away. So we have got to try to figure out a better way to do this and I think this is a good place to start. I think we can learn a lot from the way California operates and eventually, I hope that we can get the whole country on the same page in dairy policy. This hearing will get us started in that direction. So thank you for your leadership.

[The prepared statement of Mr. Peterson appears at the conclusion of the hearing:]

Mr. BOSWELL. We know you have got a lot on your plate and we appreciate you being here for whatever time you can expend.

Mr. PETERSON. Thank you.

Mr. BOSWELL. Thank you. Mr. French, welcome. We will recognize you for 5 minutes.

STATEMENT OF BILLY FRENCH, DAIRY FARMER, ON BEHALF OF VIRGINIA STATE DAIRYMEN'S ASSOCIATION; MARYLAND & VIRGINIA MILK PRODUCERS; AND SOUTH EAST DAIRY FARMERS ASSOCIATION

Mr. FRENCH. Good morning, Chairman Boswell, Ranking Member Hayes, Members of the Subcommittee and my Congressman, Bob Goodlatte. I want to thank you for the opportunity to appear here today on behalf of the Virginia State Dairymen's Association, my cooperative, Maryland & Virginia Milk Producers, and the South East Dairy Farmers Association.

I am here today as a part of what I believe is a consensus in the U.S. dairy industry, that regulated milk marketing is beneficial for farmers, processors and consumers. While we have a regulated system, it is a system that is designed to respond to the signals sent by the marketplace. When those market conditions change, the regulations are supposed to change with them. We may be living in the age of instant messaging, overnight mail isn't fast enough anymore, but our milk marketing regulations have not be able to keep up to date fast enough for several years now. So I am also here to join the consensus opinion in the industry that our rulemaking process needs an update.

Like dairy farmers everywhere, we are struggling in the southeastern United States. After nearly 2 years or rock-bottom milk prices, we now have above average farm prices. Our market-based

system is indeed responding. Projections for the next several months look relatively strong. Our input costs, however, are at record prices. Fuel prices have been high for more than 2 years. Just a little less than a year ago, the price of feed grain began a rapid climb. Only the announcement of record corn planting intentions, along with the predictions of a normal weather year in the corn belt, have started to soften the feed grain prices in just the past couple weeks. Like dairy farmers everywhere, I am concerned that our input costs to milk price ratio will remain challenging, at best, for the foreseeable future.

Unlike dairy farmers everywhere, though, we in the Southeast face these production challenges in the face of a fluid milk market that gets bigger every day. Population growth in the region far exceeds trends in other parts of the country. Federal Milk Marketing Orders 5, 6 and 7 are home to 5 metropolitan areas that experienced population growth exceeding 20 percent from 2000 to 2006. There are only a total of 16 cities that grew that fast during that time period in the entire country. The City of Atlanta, in the heart of the Southeast, is the fastest growing big city in the country. That population growth not only fuels demand, it also challenges supply because it drives up prices for agricultural land. According to the USDA's National Agricultural Statistics Service, the Southeast has the highest increase in cropland value in 2005, up $890 per acre in just 1 year to an average price of $4,550 per acre. The increase was even more dramatic in Virginia, with an increase of 21 percent in just 1 year to an average price of $4,900 per acre. State statistics show a similar increase in 2006.

To recap, we have the same challenges of input costs as dairy farmers everywhere else, but we operate in a region with a constantly growing population and where affordable farmland is increasingly difficult to come by. I believe our needs for a milk marketing regulatory system that responds to the changing market conditions might be even more immediate than we need elsewhere in the country.

The industry in the Southeast has been affected in the past few years by those higher input costs much more than other regions of the country. We have asked for and received a hearing on increasing transportation credits to help cover the cost of moving an increasing amount of milk into the region during more weeks of the year to satisfy our market. The inter-market credits have been increased but our request for intra-market credits, which would help cover the cost of moving milk within our markets, has yet to be acted upon.

The Federal make allowance hearing, while addressing Class III and IV prices only, has reduced producer income in the region, when the price signals sent to the farmers should have been just the opposite. At the same time, Federal Order Class I differentials in use today reflect economic conditions of a decade ago.

And then there is the weather. You may have heard we have had a few hurricanes in the Southeast in the past few years. Extreme weather challenges every part of the country occasionally, but here again the Southeast is different. Even before the tragic events of Hurricanes Katrina and Rita in 2005, there were Charlie, Frances, Ivan and Jeanne a year earlier. In 2004, the industry in the South-

east sent a request for an emergency hearing to seek assistance in covering the extraordinary cost of transporting milk during and after the four hurricane hits that year. Production was lost and had to be replaced, most often with milk transported from great distances and at great cost. When plants were shut down, the milk normally supplied to them had to be process elsewhere, again with additional transportation costs incurred.

We asked for a simple, temporary 3 month increase in Class I prices in Federal Orders 5, 6 and 7. Processors joined us in the request. There was no opposition to the request or to treating the request as an emergency. Our request was made early that fall, once the damage had been fully assessed. In the meantime, farmers in the entire region bore the additional milk marketing costs associated with the four hurricanes in a row. With all of this being said, however, the USDA AMS staff is operating within the current requirements of the system. Federal Order rulemaking must follow set protocols. Interested parties are allowed to have their say.

I see that my time is up, so I think I have covered most everything. Thank you.

[The prepared statement of Mr. French appears at the conclusion of the hearing:]

Mr. BOSWELL. Thank you, Mr. French. The chair would now like to recognize Mr. Ooms.

STATEMENT OF ERIC OOMS, DAIRY FARMER; MEMBER, BOARD OF DIRECTORS, AND CHAIRMAN, DAIRY COMMITTEE, NEW YORK FARM BUREAU

Mr. OOMS. Thank you for the opportunity to be here today. My name is Eric Ooms. My father and two brothers and I own and operate a 400-cow dairy in Chatham, New York. We also grow approximately 1,800 acres of corn, alfalfa and grass for our herd and sell some to neighboring farms as well. I serve on the New York Farm Bureau Board of Directors and also as the Chairman of the New York Farm Bureau Dairy Committee. The Farm Bureau is a general farm organization and it is in that capacity that I will be addressing you today.

As a dairy farmer, I would be remiss if I did not emphasize the importance of the MILC Program and how important it is to have it extended in the farm bill and returned to the 45 percent rate that it started at in 2001. I realize that is not the charge of this hearing, but I had to mention it.

With the recent negative price/cost paradigm that the dairy industry has endured, many farmers are calling for closer scrutiny or elimination of the Federal Orders. While I do not have any objection to reviewing the Orders to assess whether the current patchwork structure with so many unregulated and state-regulated areas is practical, to eliminate them at this point may be shortsighted. It is important to remember that the Orders exist in large part to facilitate the movement of milk within a region, not necessarily to ensure a fair price to my farm or any other farm, for that matter, even though we found today that their website says something different.

The first thing that comes to mind is the urgent need to amend the Federal Order System in such a way that it would be more re-

sponsive to changes in the marketplace. With the recent high energy prices, there were several calls for USDA to review and adjust the make allowance for cheese. Several cooperatives asked for an emergency hearing on this issue as early as March 2005. It took until November 2005 to agree to hold the hearing, which was held in January 2006. Based on testimony presented in January, the Department decided to have a follow-up emergency hearing in September 2006. By November 2006, a decision was reached. Despite an unsuccessful lawsuit, the new rule was implemented in February 2007. That is 2 years to commence and act on an emergency hearing. I can only guess that if there were a call for a hearing and it was not seen as an emergency, the Department would still be gathering facts about what the Wright Brothers had been up to in Kitty Hawk, North Carolina. Regardless of what one thinks about the need for the changes that were made, this process should be able to be completed in 6 months or less. While this was going on, California, which has a state order, dealt with the exact same issue and the process took less than 5 months. As a producer, it would be easy to think, why can't we in the Northeast simply opt out of the Federal Order and do it that way? But when you realize the number of States that we are dealing with in our milk shed, it is not that simple.

It would also be a good idea to include the ability for the Federal Orders to have the authority to add in a fuel price adjustment mechanism that can be paid by handlers. As it currently stands, when our haulers need more money to haul milk, and no one can doubt that these costs are legitimate, it always falls on the backs of farmers. There has to be a practical way to push this cost to a place where it is not 100 percent on the backs of farmers. With the recent low milk prices, there has been a great deal of concern about whether our cooperative system is working for us. Let me state clearly, I feel that the answer to dairy farmers' problems can be cooperatives, so I would implore all of you to retain or strengthen Capper-Volstead. This does not mean that there does not ever need to be oversight of cooperatives or that being certain that cooperatives are doing an adequate job of educating their members as to what is happening with an industry. One tool that we use to keep informed is we get a monthly newsletter from the Federal Milk Market Administrator so we can keep an eye on our cooperatives.

One other thing of concern is the lack of oversight in auditing over price reporting through the NASS survey. It is more than a little disturbing that my family's income is based on a survey that essentially uses the honor system. Whether there is fraud or not, whether it is malicious or not, USDA needs to audit the reports just to be certain that they are correct.

Lastly, part of the reason why we need to streamline the process is the petition that is currently before the Department that would increase the price of milk for Class I and Class II. With the price of a gallon of milk in Brooklyn tied directly to the price of a 40 pound block of cheese in Chicago, there certainly is merit to having a hearing to deal with the issue. The length of time that this hearing will take is an effective barrier for any regular farmer from following or participating in the process, because few of us have 3 years to follow a hearing process.

I thank you for the opportunity to speak here today and I would be happy to entertain any questions you may have.

[The prepared statement of Mr. Ooms appears at the conclusion of the hearing:]

Mr. BOSWELL. Thank you, Mr. Ooms. The chair recognizes Mr. Gallagher for 5 minutes.

STATEMENT OF EDWARD W. GALLAGHER, VICE PRESIDENT,

ECONOMICS AND RISK MANAGEMENT, DAIRYLEA COOPERATIVE INC.

Mr. GALLAGHER. Good morning. My name is Edward Gallagher. I am the Vice President of Economics and Risk Management for Dairylea Cooperative. Dairylea is the largest dairy cooperative in New York State and the largest dairy cooperative in the Northeast and the fifth largest in the United States. We want to thank you for holding this hearing and we want to thank you for inviting Dairylea to testify before you today.

Dairylea is strong and our 2,400 members are strong supporters of the Federal Order System. We think it is one of the most important economic development programs for the United States dairy industry that has ever been implemented. However, the rule-making process does need to change. Federal Orders will need to change to survive. The Orders must adapt to changing markets, marketing conditions, business practices and technological advancements. Federal Orders must be able to quickly adjust the regulations as circumstances arise if the program is going to remain relevant. Presently, the process of changing Federal Orders to adapt to these changes takes far too long. Reform of the process is necessary.

As part of this reform, the Secretary of Agriculture must have a mechanism that allows him or her to quickly address issues that are causing disruptions in the marketplace. For instance, incentives to increase ethanol production are leading to strong increases in livestock feed prices without a commensurate response in the milk price, or at least not one that has shown up to a large enough degree yet. This has compounded the dairy farm profitability issue emanating from higher input prices because of energy-related items. The Secretary of Agriculture must have tools at hand to react quickly. It would help, for instance, if a decision to raise Class I prices could be immediately implemented. As it is, a hearing about increasing Class I prices ended 4 months ago and the industry has no idea when the decision might be issued.

The present operation of the Federal Order hearing process has resulted in hearings with no resolutions or hearings where the ultimate resolution takes years. The failure to provide quick decisions has implications on the underlying support for the Federal Order program and generates business risk for dairy farmers, plant operators, and businesses that market dairy products. Dairylea has proposed for consideration and debate an 8 point plan to improve the situation.

First of all, the Secretary should have authority to quickly increase milk prices. Second, there are two national Federal Order hearings that have concluded without a final decision being imple-

mented or the proceedings terminated. This Committee should urge USDA to move to a final Order and implementation within the next 45 days. Third, it has been testified today about a number of initiatives taken by USDA to speed up the hearing process. These should be acknowledged, supported and encouraged to continue. Fourth, an independent review should occur relative to the hearing process and the post-hearing decision process. Fifth, statutory changes to the hearing and amendatory process are needed. Strict timelines are needed in order to get timely decisions. The *Code of Federal Regulations* should be amended to facilitate a different and faster hearing process. Deadlines for the steps of the process must be included. As part of this process reform, there must be greater interaction between those seeking changes and USDA prior to requesting a hearing. Industry-wide pre-hearing conferences and the advance submission of hearing testimony must be required. The industry has to work better together, USDA, cooperatives, milk plants, the entire industry needs to work differently to get better solutions. And the proposal that Dairylea has made in *Exhibit 1*, I believe can result in more timely information. In fact, if the industry works together the right way, USDA should have all the information they need, for the most part, to make a decision before the hearing even starts, if you have advance submission of testimony. Most of the hearing record that has any relevancy to it is in the testimony of the people testifying at the hearing. If this is already in before the hearing starts, USDA can already start their economic analysis before day one of the hearing. I think that is vitally important.

Sixth, hire and retain additional Administrative Law Judges and make sure there are professional court reporting services. Seventh, increase the use of the market administrator's staff members. USDA will be challenged to be able to maintain the professional staff that it needs to work through the complex issues. There are cost-of-living issues, there are quality-of-life issues working in an expensive market such as this. USDA is fortunate to have a number of satellite offices around the country, including one in Albany, New York, that provides a much more stable quality of life that I believe can help them attract and retain high-quality people that can help them move through this hearing process.

And finally, I believe it is necessary to have the Secretary of Agriculture make at least an annual report to this Committee on how the Federal Order hearing process, amendatory process, is coming and what changes have been made and to make a report that encapsulates what is going on in the Federal Order program.

With that, my time is up. I thank you again for the opportunity to testify before you and I look forward to any questions you may have.

[The prepared statement of Mr. Gallagher appears at the conclusion of the hearing:]

Mr. BOSWELL. Well, thank you, Mr. Gallagher. I appreciate all of your comments, particularly that last one. That is what we are just buzzing up here about. That was a good thought. In fact, you lined up quite an order of priorities, so I assume you had them in order of precedence?

Mr. GALLAGHER. Pardon me? I am sorry.

Mr. BOSWELL. Was your number one recommendation for what we——

Mr. GALLAGHER. It has to be done.

Mr. BOSWELL. It has to be done. Well, with that, I think I will just ask the rest of the panel to tell us what would be your top recommendation, if we would do something to improve the Federal Order System. No particular order. Whoever is ready to respond. What is your top recommendation? Mr. Ooms, we will just start with you. We will just go down the line.

Mr. OOMS. I would just say that I had a number of suggestions that would just expedite the process, because there are a lot of things that USDA has the power to do. As a small businessman and dairy farmer, I hear bureaucrats tell me that it takes 10 or 14 months and it is just not good enough. We can do better than that. We are living——

Mr. BOSWELL. I think you have all made that very clear, but if you were just to say tomorrow you will do something first, what would you have them do?

Mr. OOMS. From my farm perspective, I would have them decouple Class I from the cheese price.

Mr. BOSWELL. Okay. Thank you. Mr. French?

Mr. FRENCH. In this process, if we would just set a timeline to have timely regulations that we can live with, it would be the number one thing today.

Mr. BOSWELL. A timeline, okay. Mr. Donohue? Thank you.

Mr. DONOHUE. Possibly even reducing the number of Orders from 10 to possibly even looking at a single Order.

Mr. BOSWELL. One Order, okay. Mr. Kraft?

Mr. KRAFT. Make decisions on hearings that have already happened.

Mr. BOSWELL. Make decisions on the hearings that have already happened, okay. That is a good comment. Okay, with that, Mr. Kraft, you mentioned that the California system does an unparalleled job of collecting industry data for hearings on price formulae. In your opinion, where is the USDA falling short of this data collection?

Mr. KRAFT. Well, there is no auditing process on the survey. They don't check. They need to check the numbers and make sure they are right.

Mr. BOSWELL. Okay. All right. Mr. French, you said in your testimony that the Class I differentials in use today reflect economic conditions of a decade ago. What should they be?

Mr. FRENCH. The Class I price in the Southeast is probably reflective of the value of Class I, but our blend price is getting reduced down by the lower-class usage that we have. And the Class I, the producers that I talk to in the field look at the price in the grocery store and they always relate that back to the hundredweight they are receiving and tell you there is no relationship. And when the price of the Class goes up in the grocery store and their farm check doesn't show it, then they ask you why. I served on the Board for 3 years and that was always the question you got, why is the price for milk so high in the grocery store and yet we are getting so little on the farm? And so the average producer out there, that is what they see day to day as the value of his product,

is that grocery store price and they don't see that correlation between the grocery store price and his farm check. And so they are all going to tell you that if the value of their milk is what it is in the grocery store, then the value at the farm needs to be higher and they will tell you that 100 percent if you meet at the farm gate or at the auction. That is what they are all going to hit you with. They will all tell you it is going to be higher somewhere. They see a value somewhere with the grocery store. Now, we all know that is not realistic, but it certainly needs to go hand in hand.

Mr. BOSWELL. Now, if it gives you any comfort as a farmer myself, as a cow/calf producer, I have noticed that in the cost of beefsteak. However, your point is well made and I appreciate it. The chair would recognize Mrs. Gillibrand for 5 minutes.

Mrs. GILLIBRAND. Thank you, Mr. Chairman. I would like to talk to each of you about your ideas for change. So Mr. Ooms, can you talk about what you think the impact would be if you decoupled Class I from the price of cheese? And then I would like the other panelists to also describe what they think the impact would be.

Mr. OOMS. Well, it would depend on what region of the country you are in and what your Class I would be in your region. I know the biggest thing for us is we do have Class differentials that do address this, but it would make a big difference in that, and he just talked about it. The price of milk in the stores are based on what they can get for their product. But if you think about it, our milk is largely set by the price of cheese in Chicago at the Mercantile Exchange or the NASS, which is obviously unaudited. So it is going to be different in every area of the country, but there should be a price discovery mechanism, whether it be regional or national, for Class I milk. As far as the impact to my farm, it is going to vary. I couldn't give you that right here today. I could get back to you on that.

Mrs. GILLIBRAND. But to the broader issue, it sounds like, certainly from our region of the country, the price of milk is just too low and it is typically too low and it doesn't reflect the cost of producing the milk, and I understand that the cost differentials for Class I are supposed to reflect that. Do you have any sense, as just a producer, why these price mechanism aren't working? Do they, perhaps, not have enough influence in the formula?

Mr. OOMS. Well, I think part of the problem is, is I know that with the make allowance change, they were asked to change the make allowance for cheese to reflect the transportation or the fuel costs to go into making cheese. At the same time, they were asked to, I know I talked with Ed about it, about changing the differential for Class I and the judge kind of set that aside because it was too controversial. And then the industry was segmented, because we all agreed on the whole package, but the way the process moved so slow, it was important to those that were cheese producers to get that fixed right away and we knew if we included the Class I, if the process was sped up, even if they didn't address Class I at that point, at least we would have had a hearing on it. But the problem is, as you get too many issues on the plate, you end up cutting stuff out, because when I see that the Southeast producers have their thing, and I agree with what they are asking for, and

I said to myself, this is never going to happen because they are just never going to get to it.

Mrs. GILLIBRAND. Thank you. And many of you have talked about transportation costs and you do refer to that in your testimony. If transportation costs weren't wholly absorbed by the producers, what could an alternative system be to address the differential issue?

Mr. OOMS. This is for me?

Mrs. GILLIBRAND. Well, I will finish with you and then I will go to the others. Thank you.

Mr. OOMS. Okay. I know that Ed and some of his contemporaries in the Northeast, and I would defer to Ed on that, as far as how we could accomplish that.

Mrs. GILLIBRAND. Ed, go ahead.

Mr. GALLAGHER. Thank you. Relative to passing hauling on up through the marketing channel to the consumers, I think, is vitally important. There a number of initiatives that have been undertaken already. We have some fuel surcharges that we pass along on some of our sales of milk already. The Pennsylvania Milk Marketing Board, a state regulation has recognized that particular issue and in their state regulation they have a fuel surcharge. I do believe that there should be some sort of a surcharge mechanism under Federal Orders to help pass those costs along to the final consumer, where they should be paid.

Mrs. GILLIBRAND. Okay. Thank you. Anyone else on those two issues?

Mr. KRAFT. We are in a difficult position because we pay fuel to the farm for all our input costs and we pay fuel from the farm for the milk that is going to the plants. So I know you talk a lot about the cost of moving the milk from the farm to the market, but we are getting hit on both sides, as well as harvesting costs. So the fuel costs on our operations is totally absorbed by us and I don't have any solutions to that, other than that it would be nice if that was shared a little bit. We have some processor friends behind us. I don't know if they would have the same opinion, but it would be pleasant.

Mr. FRENCH. If you have a discussion about transportation costs in the Southeast in the past year, you would have really got beat up, because not only do we have the transportation costs of our own milk, but in the Southeast we are hauling supplemental milk in to cover our needs and the dairy farmers in the Southeast were covering that cost too. I know that first panel said that we had a minimum blend that we could receive, but in the Southeast, because of those transportation costs, we actually received the low blend for a good many, the last 2 years, because of that supplemental cost to haul the milk in to service the market was bourne by the dairy farmers. We have done a lot of work in the last year, on behalf of a lot of people, to get that changed around to gain some efficiencies and correct that, to where now we are at least above the blend. But that transportation cost is huge when the price of fuel goes to $3 a gallon for diesel and the distance that we are now hauling milk to cover all of those markets.

I don't know that the system will ever be able to respond fast enough, as fast as our fuel prices go up and down. When the fuel

hits $3 and we start processing in Washington, D.C., the price drops back down and it is no longer an issue. There has to be something in place so that those agencies that oversee those milk marketings can control that issue at the time. That is just something that is going to have to be in place if they can call on and do and not have a hearing. But the transportation in the Southeast has been huge for the past and that has to do with all over the country, the system that was set up was set up for a surplus that was all over the United States and how we have certain areas that are deficit and other areas that are surplus that were not surplus 30 years ago. So it is changing and our system is just not changing fast enough to meet those.

Mr. BOSWELL. Excellent discussion. Thank you very much. The chair recognizes Mr. Goodlatte for questions for 5 minutes.

Mr. GOODLATTE. Well, thank you, Mr. Chairman. And I want to particularly welcome Billy French, who is a constituent and very knowledgeable dairy farmer. His son was a page here at the Capitol last year and I know, from that, that he is not only a great dairy farmer, but also a great family man, so welcome, Billy. I want to welcome all of you. I appreciate your testimony here today and I would like to hear from each of you what you, as dairy producers, recommend this Committee do legislatively to speed up the process the USDA uses to amend Federal Orders. You could tell from the testimony of Administrator Day, that they are searching but they are somewhat reluctant to tell us to think outside the box and do something pretty dramatic. But given not only the problem with fuel costs, but also with feed costs, which change and sometimes can change fairly rapidly, as we have seen with corn prices over the last year. They need to be able to respond to you much more quickly. So what specifically can we do in that regard? Mr. Kraft, I will start with you.

Mr. KRAFT. Well, providing that the legislative process is faster than the milk marketing process, which moves faster is somewhat debatable, I would hope that——

Mr. GOODLATTE. Well, it is, but your timing is good because we are going to write a farm bill this year and the farm bill is the place to put this.

Mr. KRAFT. Well, like I said in my testimony, what we really need is a process that works and is much more responsive. And so I would hope that if they don't do it themselves, if you would require them to do some reporting, to do the audits on the reporting, to do some timely reporting as far as the process of a Federal Order hearing would go. So that would be my recommendation, is to hold their feet to the fire and make them have some deadlines so that the process moves ahead.

Mr. GOODLATTE. Thank you. Mr. Donohue?

Mr. DONOHUE. Yes, I think the same thing. You could look at doing it legislatively, but in issues regarding Federal Orders, it does become very controversial and regionalized, and it can get bogged down in the Congressional type of situation just as well.

Mr. GOODLATTE. Let me correct any misimpression here. We are not going to decide, on a case-by-case basis, what the transportation allowance is. What we are trying to do is change the process so that the Administrator and the USDA are required to make

their decisions much more quickly. We are not under any illusion that there isn't going to be the same controversy there has always been between regions of the country, between producers and processors, and everything else that goes into this. But like many other sectors of our economy, people face controversy and make decisions much more rapidly. As I indicated to you, if you think this is controversial, think about what investors think about whether or not interest rates should be raised.

If you are going to pay for credit, you don't want those interest rates raised. If you have money you are lending, you want the interest rates raised. That comes out where the rubber meets the road. But when the Federal Reserve meets, they make a decision, they make the decision quickly and it takes effect immediately. Now, when prices change for energy, when prices change for feed, when the market shifts because of changes in demand and changes in technology that have enabled us to ship from the Shenandoah Valley our milk greater and greater distances, now it is going down to South Carolina and Georgia, we need to have a recognition that that costs somebody money to do it and we are not going to be producing it much longer if it costs more to produce it and ship than you get paid for it.

And because this is not a free market system, this is a very tightly government-controlled system, and if there is consensus on eliminating that and going to a free market system, I would like to hear about it. But I haven't heard that, so we have got to change the government-controlled system to respond much more rapidly than it does now. That means everybody gets to have their say, but then quickly make a decision about what the change is going to be. Don't study the request, then set a date for a hearing, then have the hearing and then take months to examine the hearing record, then come up with a decision that might be a year or more late to the changes that have already taken place in the market. If you agree with that effort to both have them administratively change some of their procedures and for us legislatively to change what they can't change administratively, those are the ideas I am looking for.

Mr. DONOHUE. Yes, in my testimony some of the points I made out to Mr. Gallagher have a precise timeframe, that once a request is made for a hearing, you have 2 to 3 weeks to grant the hearing. You have so long in the hearing process. You have so long and hold their feet to that. And if there is clear, concise criteria in every step of the way, it is going to speed up the whole process.

Mr. GOODLATTE. Thank you. Mr. French?

Mr. FRENCH. And I agree with what both of those gentlemen presented in their testimony. Certainly there is a process where we can have a timely decision made and we certainly don't have it now. It is not going to solve all of the problems in the industry, that is for sure. It is not going to solve all of the contention that we have out there. But I think everybody would agree that if we had a timely decision-making process and everybody understood it, it would go towards alleviating a lot of those concerns and aggravation that we have today.

Mr. GOODLATTE. Thank you. Mr. Ooms?

Mr. OOMS. I could just reiterate what they have said and what you have said. I am not the expert here on this issue. I am looking at it from a dairy farmer perspective and I am just going to say that it needs to be fixed and there is no reason why we can't give them timelines. I don't want to close anybody out of the process, but when I heard them hemming and hawing about the need for consensus in the industry, just because there isn't consensus doesn't mean that they can't take the facts and make a decision based on the facts. I don't believe they look for consensus. I believe they try to make a good decision. So this whole, "We need to develop consensus" I don't buy that. So the need for more time for consensus is probably not realistic.

Mr. GOODLATTE. Madam Chairman, my time has expired, but I would like them to expand on that in one area that I think you and the gentleman from Wisconsin would also be interested in, if I might. The USDA has testified, I don't think today but previously, against mandating time-frames, which is exactly what Mr. Donohue mentioned, in the law since it conflicts with their discretion to prioritize amendment petitions. And I wonder, Mr. French, I will start with you and Mr. Donohue, tell us what you think about that. Do you think that we should not mandate specific time-frames that they have to adhere to, so that they could move one petition ahead of another if they think it is more urgent? Or do you think we should say find the resources to address all of the petitions that are coming at you, in a timely fashion?

Mr. FRENCH. I think, in the speed in which today's industry operates at, we don't have the luxury to prioritize and take one issue at a time and I don't think they should, either. I know when I have a cow that is sick and a child that has to be somewhere in school, I have got to figure it out and get both of them done. I don't have a chance to say, well, the cow dies and the kid gets to school. It is not an option on my part. We handle everything that comes across the plate today and get some done in a timely fashion or we are not in business. I think that the people that we pay in the government need to do the same thing. It is sometimes a rough day. I understand that very well. But you still have to get it all done.

Mr. GOODLATTE. Mr. Donohue?

Mr. DONOHUE. Yes, I agree. You hear sometimes, that it was hard. We couldn't schedule an Administrative Law Judge and things like that. But if people have their ducks in order, the hearing has been requested and the timeframe should be followed.

Mr. GOODLATTE. Mr. Kraft?

Mr. KRAFT. In business you have an incentive to do things in a timely manner, as was said before, and in government it is a lot of times the opposite. If you work yourself out of a job, you don't have a job anymore. So you have to have some sort of an incentive or some sort of structure to make sure that things happen in a timely manner.

Mr. GOODLATTE. Mr. Gallagher, I neglected you in the first question, so you close. Mr. Chairman, in your absence, the Chairman was very generous with her discretion.

Mr. GALLAGHER. Thank you.

Mr. BOSWELL. Actually, we are all that way over here.

Mr. GALLAGHER. USDA has had plenty of time to perform to the market and meet self-imposed deadlines. They have not. They need to have deadlines established for them to get the process done faster.

Mr. GOODLATTE. Thank you. Thank you, Mr. Chairman.

Mr. BOSWELL. You are very welcome. Dr. Kagen?

Mr. KAGEN. Thank you, Mr. Chairman. I was a little confused there with all of this discussion about timelines and dates and deadlines. I thought we were talking about our involvement in a religious civil war in Iraq. Mr. Gallagher, as an economist, are you really suggesting that the Secretary of Agriculture should have the power to determine milk prices?

Mr. GALLAGHER. I believe that the Secretary should have some sort of an authority to be able to quickly react to cost price squeezes, like those that are hampering the dairy industry right now.

Mr. KAGEN. Is that a free market description that you have just described?

Mr. GALLAGHER. No, I think we could set up some sort of parameters. For instance, you could do something that would say that if the milk/feed ratio was below some number for a certain period of time, then something should be done on the Class I price. Something like that could be happening and there could be some ability for them to just go and within 30 to 60 days have it implemented.

Mr. KAGEN. And then a ratio also for fuel costs?

Mr. GALLAGHER. Sure.

Mr. KAGEN. A ratio for hired hand costs?

Mr. GALLAGHER. Pardon me?

Mr. KAGEN. Hired hand, you know, employee costs?

Mr. GALLAGHER. It would be easy for an economic analysis to be put together that could show something like that, in fact.

Mr. KAGEN. And a ratio for healthcare costs?

Mr. GALLAGHER. Yes, we are working on a cost of production formula right now within Dairylea to utilize in regulatory proceedings.

Mr. KAGEN. So you don't have any concerns about the Secretary of Agriculture possessing too much power? You think that the Congress or some form of legislation could rein him or her in?

Mr. GALLAGHER. Again, with the right parameters wrapped around it, I believe it could work.

Mr. KAGEN. Well, I have been a small businessman for over 25 years and I have been moving at the speed of business and now I am moving at the speed of government, so you understand there is some hesitancy for me to really accept that that is really going to be very functional.

Mr. GALLAGHER. I understand.

Mr. KAGEN. And again, Mr. Gallagher, would you agree with this Dutch fellow sitting next to you, the Dutch farmer? I know if you are not Dutch you are not much. I have heard it all. From my area of the country, the V's in the phonebook are extensive, van this, van that. Would you agree with him that we really need greater oversight and audits, and have you done any audits of pricing?

Mr. GALLAGHER. We audit our internal operations, surely, relative to, I think if you are referring to audits of the NASS price survey——

Mr. KAGEN. Yes.

Mr. GALLAGHER.—I think it is a huge problem that there are no audits being done already and it is beyond my ability to comprehend why that is not occurring.

Mr. KAGEN. Would you call it shocking?

Mr. GALLAGHER. Yes, I would.

Mr. KAGEN. Okay. And I don't mean to pry into your businesses, but what is your cost per hundred? Mr. Ooms?

Mr. OOMS. I would guesstimate, because there are so many variables that go into it, but when we can stay around $15 a hundredweight; there is a lot of belt tightening. But that would just be a ballpark guess.

Mr. KAGEN. In the last 3 months, what is your average payment per hundred?

Mr. OOMS. Actually, the last 3 months we have been just over— just around $15.80, $15 and we dropped down below around $12 for a good number of years. But the last 3 months, because of whey prices rebounding, if it was actually reported correctly, it probably would have been more, but that will be discovered. So the last 3 months they have been around $15.85, $15.58 and the last one was $16.30.

Mr. KAGEN. Mr. Donohue?

Mr. DONOHUE. I am a quad manager and we don't really—all our members are in proprietary dairy plants and we don't pay those.

Mr. KAGEN. Okay.

Mr. DONOHUE. So I cannot reflect on costs of production.

Mr. KAGEN. Mr. Kraft?

Mr. KRAFT. I think Mr. Ooms is probably right. It is very difficult to tell from month to month because of fuel prices changing so fast and I can tell you that, in the last 6 months, our feed costs have moved up 47 percent and that is a real number. I paid $19 a ton for corn salvage in the field last fall and we just made contracts with the guys, the farmers around us that grow corn for us and we are going to be paying $28 a ton this year. So that tells you what is going on. And it is very difficult to give you an accurate number. We kind of do it for a whole year, which is a conglomerate.

Mr. KAGEN. Yes.

Mr. KRAFT. But when costs are moving up so rapidly and the price that we receive for our milk lags behind it, not responding, that is where we get caught in a squeeze.

Mr. KAGEN. Thank you all for your time. I appreciate you being here. I yield back.

Mr. BOSWELL. Well, I would like to thank the whole panel. It has been an excellent discussion and worth our time to have you here. Thank you very much for coming and we are going to excuse you at this time, and I invite the third panel to come to the table. I welcome to the third panel to table and apologize for the long delay you have had. You have been patient. Thank you very much. We appreciate it. And so we will just get started right away if we can. We have, just for introductions, Mr. Mike Reidy, Senior Vice President, Procurement, Logistics and Business Development, Leprino Foods Company, Denver, Colorado. Welcome. Mr. Warren Erickson, Executive Vice President and COO of Anderson-Erickson Dairy Company in Des Moines. Welcome. Mr. Doug Wells, Co-President

of Wells' Dairy, Incorporated, La Mars, Iowa. Welcome. You didn't bring any samples. No, I am just kidding. Mr. William Ahelm, Co-Founder and Vice Chairman of Hilmar Cheese Company, California. Welcome. And Mr. John Hitchell, General Manager, Raw Milk Procurement and Regulations, the Kroger Company, Cincinnati, Ohio. Welcome. So with that, we would like to start with you, Mr. Reidy; please begin when you are ready.

STATEMENT OF MIKE REIDY, SENIOR VICE PRESIDENT, PROCUREMENT, LOGISTICS AND BUSINESS DEVELOPMENT, LEPRINO FOODS COMPANY; CHAIRMAN, INTERNATIONAL DAIRY FOODS ASSOCIATION (IDFA)

Mr. REIDY. Thank you, Mr. Chairman and Members of the Subcommittee. My name, again, is Mike Reidy, Senior Vice President of Procurement, Logistics and Business Development for Leprino Foods Company based in Denver, Colorado. Leprino if the largest mozzarella cheese manufacturing company in the world, with facilities in California, Colorado, Michigan, Nebraska, New Mexico, New York and Pennsylvania. I am also the Chairman of the International Dairy Foods Association, IDFA.

IDFA and its members are committed to working with dairy farmers and Congress on new policies that ensure a healthy dairy industry. That is why today, at hearings in both the House and the Senate, we are releasing our dairy policy proposals for the 2007 Farm Bill, called *Ensuring a Healthy U.S. Dairy Industry: A Blueprint for the 2007 Farm Bill*, and it looks like this. It can be found at *www.heatlhydairyindustry.org*.

Our comprehensive proposals include an improved dairy farmer safety net, with direct payments not tied to price or current production; greater access to risk management tools, like revenue insurance and forward contracting; a plan to identify needed improvements in the Nation's milk pricing system through the establishment of a blue ribbon commission to look at Federal Milk Marketing Orders; and securing long-term trade prospects through repeal of the dairy import assessment. A copy of our blueprint will be delivered to your offices this afternoon.

As our policy proposals suggest, the Federal Milk Marketing Order System cannot be viewed in isolation. It is only a part of the government's involvement in dairy. Federal Orders exist along side the decades-old Dairy Price Support Program and the newer Milk Income Loss Contract Program. They are supposed to operate as the principal safety nets for dairy farmers. However, if these safety net programs were working effectively and truly helping today's dairy farmers, I would argue that we would not have the level of controversy and uncertainty over the Federal Order System that brings us here today.

At Leprino, we purchase between 4 percent and 5 percent of the Nation's milk supply. We have a keen interest in making sure we keep our existing market strong while finding new outlets for the cheese and other dairy products we produce. As such, I have day-to-day experience in seeing how Federal Orders and current U.S. dairy policies impact the marketplace. Leprino does not subscribe to the dismantlement of the Federal Order System. In fact, while many in the industry think we would be better off in a deregulated

environment, there is no consensus. However, there is increasing frustration with the length of time it takes USDA to make needed changes, and mounting concern when decisions finally arrive, because they are escalating regional divisiveness within our industry. This must be examined and improved.

For example, only in the dairy industry do we have to go to the government to ask for permission to update the margins processors can use to cover their costs of turning raw milk into finished dairy products. It has taken USDA over a year to address this emergency issue, as you have heard several times this morning. And while we wait, some cheese companies and cooperatives have closed factories and many others are still challenged to make ends meet. These milk pricing issues are bound to get worse as USDA struggles to make the 1937 Federal Orders fit the business realities of today. We need strategic processes to sort out the future of the Order System. That is why Leprino supports the creation of a blue ribbon commission to analyze these issues more fully and make recommendations that are built on consensus among producers and processors.

As a company fully invested in the long-term health and success of the U.S. dairy industry, Leprino believes this Committee must pursue a holistic approach to dairy policy. We cannot find our way forward on Federal Orders unless producers have a reasonable safety net program. We think the structure of the underlying safety nets can change for the betterment of producers and processors. We support a direct payment program that would decouple payments from price and production and would be available year round to help farmers. This type of direct payment has the added advantage of not distorting markets, which is good for processors. A complete safety net also needs to provide more risk management tools through forward contracting and revenue insurance.

Finally, our dairy policies should support expanding market opportunities. This can be done by not erecting artificial barriers to trade, like the dairy import assessment, which might lead to retaliation that may threaten any number of U.S. dairy exports, including the whey and lactose products we make. Mr. Chairman, establishing a commission on Federal Orders and fixing the dairy safety net in this farm bill is a tall order, but the time has come. Thank you for the opportunity to speak to you today.

[The prepared statement of Mr. Reidy appears at the conclusion of the hearing:]

Mr. BOSWELL. Thank you. Mr. Erickson, welcome. Five minutes.

STATEMENT OF WARREN ERICKSON, SENIOR EXECUTIVE VICE PRESIDENT & COO, ANDERSON-ERICKSON DAIRY COMPANY

Mr. ERICKSON. Thank you for the opportunity to be here today. I am Warren Erickson, Chief Operating Officer of Anderson-Erickson Dairy. Oh, you got to hit the talk button. Excuse me. Mr. Chairman, you know our company well and I want to thank you for your leadership as our Congressman, on behalf of the Iowa dairy industry.

I came back to my family's dairy business after some time in the accounting industry and I am here to tell you that complicated tax and accounting issues can't hold a candle to the Federal Milk Mar-

keting Orders. That is why we support Congress creating a commission of industry experts and USDA officials to look at the future of the Federal Milk Marketing Orders and the problems that plague the system. Here are just a few examples we have experienced.

After 70 years, the Federal Government still operates a discriminatory pricing system that assigns milk prices based on the products it is used to make. At AE, we pay the highest price for the milk that we buy. We produce fluid milk, known as Class I, and yogurt and other cultured products, known as Class II. There are also two other classes, Class III for milk used to make cheese and Class IV for milk being turned into butter and powder. As far as I know, no other perishable commodity in America prices their commodities that way, and there is no real reason that milk should.

For fluid milk processors like us, we also pay more for milk based on a system that originally priced milk from the distance of a plant from Eau Claire, Wisconsin. Known as Class I differentials today, you can see from this map that the price still goes up the further you get away from Eau Claire. This regionally-based pricing method doesn't fit today's economics or dairy industry. And I can tell you from firsthand experience that the formal rulemaking process used by the USDA to modify complicated Federal Order rules is unresponsive, based on the realities of our business environment, unreasonably slow and costly to everyone involved.

Here is an example of how out of touch the Orders are. At AE, we buy from both co-ops and independent farms. We have a new dairy farm in our area and we plan to buy their milk. But how to do I explain to them that the Class I price reported every month by the USDA is what I pay for the milk but not what my farm supplier receives? In frustration, I refer to it as a communist system where the market administrator tells me what to pay instead of what my supplier and I both agree on is a fair price. In addition, it is exceedingly complicated to explain to the supplier what they will receive as payment for the milk shipped to AE. A more straightforward approach would be much easier for all parties involved. But a straightforward approach is difficult with the current system. For example, several years ago, I testified at a USDA hearing on the implementation of Congressionally-mandated Federal Order reform. Can you imagine being cross-examined by the USDA on the interplay between milk, cheese, butter and powder prices and the distance of my plant from Eau Claire, Wisconsin? I gave it my best shot.

After 3 years of deliberation during the last Federal Order reform, countless hours of testimony and hundreds of thousands of dollars spent by processors, co-ops and the government on the process, the USDA ultimately proposed a more market-oriented pricing system. However, Congress intervened and mandated a different scheme with higher Class I differentials. This result hit our bottom line pretty hard. Higher prices for our milk leads to less consumption, which not only hurts my business, but the dairy farmers as well. From my perspective, a pricing system that makes my milk from Iowa more expensive than milk going to a Minnesota cheese

plant, but less expensive than milk in Florida doesn't make a lot of sense.

You see now why we have this tension in the system. The outcome is always different depending on where your farm or plant is located and what the milk is used for. There has got to be a better way. However, nobody can agree on how to fix the Federal Order System. And fixing it will not be an easy or fast process because the problems are so complex and the solutions so politically charged.

Mr. Chairman, I believe Congress can rise above the regionalism and divisiveness that comes with trying to solve such a problem in a political arena by charging the dairy industry to work together to find consensus and solve our own problems. That is why we support Congress creating a commission made up of producers, processors, USDA officials and experts to recommend ways to streamline and simplify the system, increase its responsiveness to market forces, and ensure it is still serving the best interests of the industry and consumers.

In spite of all of the complications and uncertainties, AE will continue to do our best to meet our consumers' demand and try to increase milk and dairy consumption. We will continue to try to do business according to the highest standards of quality my grandfather established when he started our company 77 years ago. In the short term, please give us some assistance by establishing a Federal Order commission. Thank you.

[The prepared statement of Mr. Erickson appears at the conclusion of the hearing:]

Mr. BOSWELL. Well, thank you, Mr. Erickson. You have referred to that new farmer and I think I know where you are talking about, trying to explain it to him and you made the comment it is kind of like the communist system.

Mr. ERICKSON. Yes, sir.

Mr. BOSWELL. I am going to ask you to consider if maybe you could encourage or I encourage you to say, that there is a right way, a wrong way, and the USDA way, which we are trying to fix.

Mr. ERICKSON. I will take that into account, Mr. Chairman.

Mr. BOSWELL. Okay. Thank you. Mr. Wells?

STATEMENT OF DOUGLAS J. WELLS, CO-PRESIDENT, WELLS' DAIRY, INC.

Mr. WELLS. Well, thank you, Mr. Chairman, for your earlier warm welcome of Warren and I, and congratulations on your chairmanship, and the opportunity to be here today.

As a regional processor serving a national market, Federal Orders and our Nation's dairy policies greatly impact our business. At Wells' Dairy, we are constantly looking for ways to make our business processes faster, more efficient and reduce waste. Competition in the dairy industry is challenging and our margins are squeezed very tightly. We have a strong relationship with our suppliers and we take pride in dealing with all family-owned farm businesses.

Unfortunately, Federal Milk Marketing Orders and other Federal dairy programs are based on outdated, inefficient business models that in many ways impede our ability to increase sales of dairy products in the marketplace. Since 1976, milk consumption has de-

clined by 36 percent to 21 gallons per capita in 2005, the lowest level on record. Looking back, Federal Orders played an important role, helping to stabilize milk supply after the Great Depression and through World War II. However, I can't think of any other business in America where the government sets the price, constrains allowable overhead costs, requires manual reporting of what is bought, manufactured, transported and sold, and then charges us, the milk buyers, the cost of administering this system.

Let me give you an example. Wells operates partially in the Central Order. In 2005, the rules changed so that now, to qualify for the producer settlement fund, or pool, we have to ship farm milk that would normally be processed in our Omaha yogurt plant to La Mars. At the same time, we have to do the reverse and that is transport milk that is produced close to our La Mars plant to Omaha. Federal Order rules didn't allow processors to vote on this decision; only dairy farmers, and more pointedly, their co-ops were the only voters. Wells' Dairy competes with companies inside the Federal Orders, with California, which is outside the Federal system, and with some unregulated plants.

You have heard how cumbersome and slow the regulatory pricing system is and you have heard of ideas being discussed to fix the system, such as bringing California into the Federal system, or making one national Order. It is impossible to generalize about the impact of these proposals on Wells' Dairy. The devil is in the details. That is why we need a commission to study and make non-politicized recommendations and wring as much inefficiency out of the system as is possible. We can look to California for a possible model to consider. Their system does have speed and responsiveness in making cost changes.

Mr. Chairman, one way to improve the system is to take away some of the uncertainty and better manage price risk by allowing producers and processors to forward contract. Because of Federal Orders, processors like Wells' Dairy are restricted from working out price agreements or forward contracts with producers. Wells participated in USDA's Dairy Forward Contracting Pilot Program until it expired in 2004. The program was very successful. We need to get this basic risk management tool back and please, in the process, don't add unnecessary paperwork and oversight. Dairy processors and producers are intelligent business people and we do not need additional USDA hand holding.

Mr. Chairman, bringing back the Dairy Forward Contracting Program is the number one farm bill issue for us at Wells' Dairy. Forward contracting will help us plan ahead to ensure that Iowa's processing capacity can handle Iowa's growing milk supply. Forward contracting will help make it easier to do long-term planning and attract needed investment in farms and plants.

I want to finish on the point I started with in this testimony. Business efficiency can only go so far unless it is complimented by governmental efficiency. We need more efficiency in the Federal Order System and to find the right solutions will require a well thought out consensus from a commission of experts, not quick fixes. Unrestricted use of dairy forward contracting is also needed to ensure that all milk buyers and sellers can achieve greater price

stability, a key component in any successful business plan. Thank you for your time.

[The prepared statement of Mr. Wells appears at the conclusion of the hearing:]

Mr. BOSWELL. Thank you for your testimony. Mr. Ahlem?

STATEMENT OF WILLIAM R. AHELM, JR., CO-FOUNDER AND VICE CHAIRMAN OF THE BOARD, HILMAR CHEESE COMPANY

Mr. AHELM. My name is Bill Ahelm and I want to thank you for the opportunity of testifying today. I too got a lot of kicks out of hand-milking when I was a child, Mr. Chairman.

Mr. BOSWELL. You did say kicks?

Mr. AHELM. Yes. I want to thank you for the warm welcome today. I am a Co-Founder of Hilmar Cheese and 1 of its 12 family farm owners. Hilmar Cheese is the largest single site cheese and whey manufacturer in the world. I would like to say that I feel that we are in good hands today, particularly since my own Congressman, Dennis Cardoza, sits on this Committee.

I have been a jersey dairy farmer my entire life and it is a privilege to be here today to talk about dairy policy, particularly milk, natures most perfect food. My perspective comes from being an active dairy farmer and processor in California under the state milk marketing system, and we are building a plant that will be opening, hopefully, in October in Dalhart, Texas. We will become part of the Federal Order System.

Relationships between dairy manufacturers and dairy farmers have changed dramatically during the last couple of decades. Today, over 86 percent of the milk handled is handled by co-ops, dairy farmer-owned co-ops, as well as vast holdings owned by dairy farmer co-ops in the processing arena, as well as companies like Hilmar Cheese. The more seamless and more market-driven the relationship between processors and dairy farmers, the more prosperous the entire dairy sector will be. Furthermore, government expenditures will decrease dramatically because it will eliminate costly government programs.

Acknowledge, for example, the cheese manufacturing plants going out of business, particularly in the Midwest. The elaborate government involvement in these markets and the distortion of market signals not based on contemporary markets has much to do with the reason dairy manufacturing plants cannot survive. We, as a dairy sector in general, would be better off without time-consuming, cumbersome and complicated Orders that are open for misinterpretation and bias, making it impossible to reflect the dynamic market changes. Why is it that we are denied forward contracting and revenue insurance tools as a safety net? And yet we have a CCC, Commodity Credit Corporation, that distorts and creates an oversupply of product at the time it purchases that product at the extreme low prices and then later, as prices begin to rise, put the product back on the market that continues low prices for an extended time into the future. In a sense, it is a double hindrance in establishing market values for the dairy products.

Federal Order regulations and other dairy policies react very slowly to contemporary market signals. California, on the other hand, is much more responsive. By comparison, for example,

USDA's proposed make allowance update, that was requested on an emergency basis, has already taken more than a year. California, on the other hand, was able to get greater relief in a more timely response. As a matter of fact, it took them 4 months and they are already investigating and studying another make allowance proposal. This is just one example of why I don't see any benefit for California to become part of the Federal Marketing Order System.

We support programs that do not interrupt market signals. This is why we do not support the MILC Program. It stimulates production increases and mixes price signals. It also pits one dairy farmer against another, one region against another, and sometimes even one legislator against another. We should be focused on expanding the marketplace, both domestically and internationally. We also need help dealing with some other very pressing issues, such as labor and managing the cost of environmental regulations. Passage of the Ag Jobs Guest Worker Program is vitally important to dairy. Conservation-related direct payments, which could replace the MILC Program, could be a way to help farmers deal with environmental compliance and rising feed costs.

I will end by saying that, like many others today, I support changes in the way that we approach the Federal Marketing Orders. We cannot rely on California's system by merely adopting it. We need to solve other problems. I think the first step would be to form a blue ribbon commission that could evaluate. Many of the others have suggested that as well. I think it is a very important first step. I have got 17 seconds left and I want to tell you about milk. I am excited about milk. If you take a glass of milk and you look at it, it is so delicious to drink it just as it is, or you can flavor it with chocolate or strawberry and drink it. Or you can take it and you can shake it and make whipped cream out of it. You can churn it and make butter out of it. You can freeze it and make ice cream out of it. You can dry it in a powder form. You can add culture to it and make cheese. You can take the whey out of the cheese and make protein, the highest value food protein known to mankind, characteristics of milk that create weight loss. What a challenge we have. The solution to what we are talking about here today is adding value to the dairy supply, is expanding those markets both domestically and internationally. And I thank you in advance for the kinds of changes that you are implementing today.

[The prepared statement of Mr. Ahelm appears at the conclusion of the hearing:]

Mr. BOSWELL. Thank you, Mr. Ahelm. I will get it straight sooner or later here. I appreciate your testimony and we would like to recognize Mr. Hitchell at this time.

STATEMENT OF JOHN HITCHELL, GENERAL MANAGER, RAW MILK PROCUREMENT & REGULATIONS, KROGER COMPANY

Mr. HITCHELL. Thank you, Mr. Chairman. As the last speaker on the panel today, Mr. Chairman, I would like to thank you for your patience and interest in the Federal Milk Marketing Orders. My name is John Hitchell. I am the General Manager of Raw Milk Procurement and Regulations for the Kroger Company, headquartered in Cincinnati, Ohio. Kroger operates 17 dairy plants in 14 states.

They manufacture a variety of milk, ice cream and yogurt products that we sell in approximately 2,500 retail outlets in 31 states. I will keep my comments brief.

After listening to all of the speakers today, I am sure the issues and challenges surrounding the Federal Order System are clear. Kroger has a special role on this panel, as we sell directly to consumers and believe this process, the marketing of milk and government regulations of the U.S. dairy industry, is intended to work for consumers as well as farmers. My comments today are shared with our customers in mind.

As others have acknowledged, it is not an easy task for USDA to continue to operate a governmental milk pricing system that has grown more complex through the decades. I have to give USDA credit; they have tried to make the rulemaking process easier to understand and allow for more dialogue within the industry. For instance, as you have heard earlier, recently they held a pre-hearing workshop to discuss proposed changes to how milk that goes into cheese, nonfat dry milk and butter is priced. Even more important, the pre-hearing workshop allowed USDA to consider the proposed changes before deciding on whether to start the formal rulemaking process. USDA is required to base the decision to hold a hearing on whether the changes are needed to ensure an adequate supply of fluid milk and orderly marketing. So this type of workshop allowed all interested parties to help USDA understand the real-world impact of various proposals in a constructive, open and transparent dialogue.

However, less than one week after the pre-hearing workshop, USDA commenced an emergency hearing on a separate issue to make changes to the Class I and II formulae. There was no pre-hearing session this time, which was of concern to Kroger Company because these changes would have a significant impact on the cost of the Class I and II products we process and the customers we serve. I am sharing this recent experience with you to point out the need to have more of an open process and predictable pattern before starting Federal Order rulemaking. It takes a lot of time and money to get through these hearings and they increasingly result in a more complex change to the government's milk pricing rules. The bar on whether USDA should go to hearings should be consistent and set high. Federal Orders were designed to set a minimum price to ensure the orderly marketing of milk and an adequate supply, not to enhance farmer income. Whether you like them or not, other government programs, like MILC, are there to perform that task. And a thoughtful and judicious approach to Federal Order rulemaking would allow USDA adequate time to consider the potential impact on consumers as well.

Even more than the effect on our business or on our milk suppliers, USDA needs to be the gatekeeper to make sure this system works for the people who are consuming milk and dairy products every day. In reality, they are the engine that is driving this train and our future prosperity demands heavily, and some might say exclusively, on their willingness to continue to consume dairy products. If we make this system too complicated or too costly to meet consumer demands, then they may go elsewhere to fulfill their nu-

trition needs. And I can tell you, once you lose a customer, it is awfully hard to get them back.

In the same way, we need to have an open and constructive dialogue in planning for the future of the Federal Order System, and we have to broaden our perspective to take into account the impact of Federal Order decisions on consumers. That is why I join others here today to urge you to put into place a blue ribbon commission to do just that in the farm bill. A commission will allow us to talk about important and complex Federal Order issues and the various proposals that have been considered to change the system.

I would also suggest that one of the commission's primary responsibilities be to ensure that the Federal Milk Marketing Order System serves the interests of milk and dairy product consumers as well as farmers and processors. We look forward to working with Members of the Subcommittee, USDA, dairy farmers and our fellow processors to achieve this goal. Thank you again, Mr. Chairman, for considering these issues.

[The prepared statement of Mr. Hitchell appears at the conclusion of the hearing:]

Mr. BOSWELL. Thank you, Mr. Hitchell. Normally, the chair asks the first questions in the rounds of questions, but due to circumstances, I am going to yield my round to Mr. Costa, then I will claim his as the turn comes. So at this time, I would recognize Mr. Costa for 5 minutes.

OPENING STATEMENT OF HON. JIM COSTA, A REPRESENTATIVE IN CONGRESS FROM CALIFORNIA

Mr. COSTA. Thank you very much, Mr. Chairman. I appreciate your efforts in holding this hearing and the important work that this Subcommittee is doing and it is something that I think we share in common, growing up in the dairy industry. And I know a couple of the witnesses firsthand and I appreciate the passion that Mr. Ahelm and his family share with milk and milk products. Certainly, they have done a great job in California and I have known the family for many years and actually went to school with some of his family members.

A couple different questions: I am not going to get it all in 5 minutes, so I will have to submit them as we go. But as it relates to Mr. Reidy's testimony, you spoke about the assessment program. You have 11 plants around the country, the largest producer of mozzarella cheese in the world, I believe. The assessment issue that has posed problems for the 2002 Farm Bill you made reference to in your testimony. Certainly the provisions created problems with regard to some of the trade issues in terms of compliance, but I also believe you believe that the assessment might harm our ability to export products. I would like you to explain in a little more detail why.

Mr. REIDY. Thank you, Congressman. I believe the reason we articulated that in the testimony that was submitted is the fact that in the world trade environment that we are dealing with right now, to say that it is somewhat skittish is maybe an understatement. The opportunity exists for any country to retaliate with tariffs of its own.

Mr. COSTA. How successful have you been in exporting your products abroad?

Mr. REIDY. We have been very successful at this point in exporting our products abroad. We are the largest exporter of lactose into Japan and it is a very important market to us. And so consequently, we are very fearful of any retaliation.

Mr. COSTA. Okay. It is about a quarter of the product you produce or more?

Mr. REIDY. I am sorry, sir?

Mr. COSTA. Do you estimate roughly that it is a quarter or more of the product you produce?

Mr. REIDY. It would depend on different products, but some of the products it could be a quarter or more of the products we produce, yes.

Mr. COSTA. The other quick question I want to give to a couple of the other witnesses. You commented about the problems with the Federal Order and the prohibition with regards to forward contracting and such. Do you really think this task force has the ability that some are recommending to try to start over, in essence? And if we got a recommendation from a blue ribbon panel, that we could try to even out the boom and bust cycles and deal with the challenges in California?

Mr. REIDY. I do. Sir, I do believe there is an awful lot of very good ideas that are out in the marketplace being debated right now by producers and processors and I think if there were an opportunity for a commission to evaluate those ideas, I think they could come up with meaningful recommendations that would benefit both producers and processors.

Mr. COSTA. Mr. Ahelm, you have direct experience with regards to the California Milk Pooling Program and made reference to it in your testimony. I too go back. I remember when our dairy contract wasn't worth the paper it was written on prior to the 1968 Act. The McKinsey report came out recently that I believe you are familiar with. There was a big meeting last week in Modesto. I suspect you or your family were there. Do you think it has the beginning, combined with this effort of a blue ribbon task force to, for my colleagues who aren't familiar with the McKinsey report, it was an effort to look at the problems with the California plan and to try to deal with some of the boom and bust cycles that we face in California and to figure out how we might improve it and how we deal with the problems of quota in California. It goes obviously on to a lot more detail, but it is getting some interest. I am just reminded, Mr. Ahelm, with your passion for milk, which I share, that one definition of insanity is continuing to do things the way you always did and expect different results. Could you give me your take on that?

Mr. AHELM. I think you are absolutely right in terms of the McKinsey report. It was funded by the California Milk Advisory Board, so it is producer-funded. It is investigating several different options as we look into the future, the needs both from the processing side and manufacturing side and how we go about taking our products to market. I think a pressing need, however, is——

Mr. COSTA. Would you see that combined with this blue ribbon task force that is being recommended?

Mr. AHELM. Yes, I think the investigation, though, for the blue ribbon task force needs to even be broader. Certainly, considering some of the things that we are considering in California——

Mr. COSTA. Forward marketing?

Mr. AHELM. Yes, forward marketing, revenue insurance, eliminating some of the costly MILC Programs that send mixed signals to the marketplace, and support prices as well. But what we really need help with is on the conservation programs, because of our environmental costs that are skyrocketing something unbelievable and that is not only in California, that is clear across the United States.

Mr. COSTA. Right. Well, our good friend Congressman Cardoza, and my time has run out, but as he is working with our colleagues on the EQUIP program in the 2007 reauthorization to create greater flexibility in some of the other conservation programs and I think there is bipartisan support to work on that and we will certainly continue to deal with that. My time has expired, but this is something, Mr. Chairman and my colleagues, that I think this Subcommittee is going to have to continue to work on. The situation in California, notwithstanding the advantages we think that exist in the pooling plan that has existed since 1968, is needing change and revision. Maybe this blue ribbon task force, on a nationwide basis, would allow us to step back and have all the parties come together with a set of recommendations that would really allow American dairymen to do what they do best, and that is as the finest producers with the highest quality and yields of milk products anywhere around the world. It is difficult because, regionally, we are stuck in our ways to some extent and I just want to leave you with this last anecdotal story.

When I was Chairman of the Senate Agriculture and Water Committee back in the late 1990s, Congressman Cardoza tells the story because he had just become Chairman of the Assembly Ag Committee. We sat down with a panel for 10 months, with all of the dairy interests, and I think some of my friends remember this, with the notion that we would meet once a month to talk about reforms and that we wouldn't want to kill the goose that laid the golden egg with regards to the pooling plan. I must tell you, after 10 months of meeting religiously once a month, we were no further along at the end of the tenth month than we were on the first meeting in terms of the parties holding firm to their convictions and they weren't going to change. Whether it was the producers or the processors or the handlers or the co-ops, it was the other fellow or folks that were wrong, wasn't them, the other folks just needed to change. If we are going to make a difference here, I think we are going to have to have a better attitude than we had in our efforts there in California and I want to be a part of this effort and I know, with your leadership, we can make a difference here if we do it right.

Mr. BOSWELL. Well, thank you very much. We will give it a try and thank you for staying and being able to participate. I know you have another requirement. At this time I would like to recognize Mr. Hayes.

Mr. HAYES. Thank you, Mr. Chairman, gentlemen. Mr. Costa, thank you for the encouragement there, for the timely way in

which you all solved all these problems. I want a volunteer and before I ask the question, you all can talk among yourselves. This is a volunteer. And it sort of follows up on what my friend from California just said. And I appreciate the frustration that processors and others feel with the Federal Milk Marketing Order System. What I don't understand is why you are requesting that we establish a commission, blue ribbon or otherwise, to continue studying the inefficiencies in the system while you all are here with the expertise that you clearly bring. Would you volunteer to offer some recommendations and we could get out of the way before we form another commission?

Mr. REIDY. Congressman, I might take a first pass at that. In terms of specific recommendations, I will just say the commission is one that we believe is important in trying to sort a number of contentious details but first and foremost, in terms of specific recommendations, we believe that there needs to be a safety net, but it needs to be a different safety net. The safety net right now is a composition of MILC payments and dairy products for payments and quite honestly, those work at odds with each other.

A much better safety net is one that would potentially support direct payments. At times this could be used to support the environmental compliance costs that Mr. Ahelm referred to. It also could involve risk management tools, including revenue insurance and forward contracting. Those are very practical solutions that I think could be implemented. The blue ribbon commission we are looking at, ordinarily it is dealing with Federal Orders. But as we mentioned earlier, Federal Orders are only a part of the complex tapestry that is the dairy issue and it is really some of these other things that we think can be dealt with in the farm bill.

Mr. HAYES. Well, again, I didn't want to lose your expertise while you were here. I think you had a thought, Mr. Hitchell?

Mr. HITCHELL. Well, I, too, believe that we need a safety net that gives us the opportunity of having forward contracting and revenue insurance. And so the greatest opportunity is looking at the marketplace. As we look at that marketplace, there is no reason why we shouldn't be expanding the use of dairy products. As nature's most perfect food, that is the direction and the signal we need to get out to the marketplace. We do that more directly in California because we have a responsive system that does react in a more timely basis to those signals.

Mr. HAYES. Okay. That is very helpful. Mr. Hitchell, I was asking one of my folks why organic milk was so much more expensive than non-organic milk and one of the questions is, I don't want to stir up a hornet's nest here, Mr. Chairman. Why is the retail price of whole milk $3.32 a gallon and the producer is only getting $1.26? You are in the witness protection program. We won't let them get you.

Mr. HITCHELL. Mr. Chairman, we strive to provide good prices to our customers every day and to be competitive in the markets that we operate. However, my area of expertise relates to the Federal Milk Order Program and how we interact with USDA. I won't be able to speak to any issues relating to retail pricing today, but I would be happy to work with you to get the answers to any questions that you may have.

Mr. HAYES. Well, thank you. Along the same line, I think you said earlier that you want to be responsive to the cost issues based on consumer demand, we don't want to price the product out of reach and lower the amount of consumption, but by the same token, I am amazed at the difference in the price in this organic milk. You get grandchildren, you notice those kind of things and the price of other mile, so there is selective ability to absorb what seems to be unusual prices *versus* normal prices. Any comment?

Mr. HITCHELL. Well, sir, I can tell you a little bit about organic milk in the fact that the regulation that USDA sets up makes it a time consuming process for a dairy farmer to become regulated to become certified organic, plus all of the feed has to be certified organic and the cost of that is significantly higher, hence the cost of organic milk is significantly higher than the traditional milk that we have in our stores.

Mr. HAYES. Need to put our marketing expert, Mr. Ahelm, on that. People know that they are willing to pay it. The same thing is true for milk, right, Mr. Ahelm? Mr. Chairman, I will let him go here. I yield back.

Mr. BOSWELL. Thank you. Since I am a little bit out of order, I am going to go ahead and continue out of order and recognize my colleague from Iowa, Mr. King. Thank you for joining us.

OPENING STATEMENT OF HON. STEVE KING, A REPRESENTATIVE IN CONGRESS FROM IOWA

Mr. KING. Thank you, Mr. Chairman. I appreciate you holding this hearing and an opportunity to work together here as Iowans. So perhaps I will just turn my first inquiry to one of your constituents and that would be Mr. Erickson. If I could pose a question, in the district that Chairman Boswell represents, there is a newspaper there that published an article on forward contracting and milk not that long ago and although I turn to that paper for advice continually, I wonder if you could give me some advice in response to the implication in that story which would say that, by my reference, that the reason processors want the right to forward contract is because they want the right to pay below minimum price. It seemed to be the theme in that article. Would you care to respond to that, Mr. Erickson?

Mr. ERICKSON. Representative King, Mr. Wells knows a little bit more about that, since he was involved in the pilot program, but I will tell you that our end result is not to—we need a joint relationship with the dairy farmer. Our end result isn't to drive them out of business. Forward contracting enables them to have the expectation of what their product will garner and they can plan accordingly. If you took a long enough timeframe, you would show that the highs and the lows would even out and their average price would be the same under both systems.

Mr. KING. I thank you. Mr. Wells.

Mr. WELLS. Well, from our standpoint, we think the article got some things wrong. Generally, it was a good article, but there were a few things that were not quite correct in there. Forward contracting is not about procuring milk below the minimum price. Contracting is about stabilizing the milk price. And some of the questions earlier about the difference between the finished product

and the raw product price, I don't know that finished product prices are so high so much as they are so unstable; they fluctuate and raw milk prices do, too.

So forward contracting is a huge business tool that is very effective in taking some of the peaks and valleys off those price variations over time and you work within a tighter range, have better control of your costs and it is a great business strategy. It is a proven winner and it works. The pilot program of 2000 to 2004 is a perfect example. It was very successful in Iowa. And we are asking for permanent, long-term authority to be able, for proprietary processors, such as ourselves, to be able to forward contract.

Mr. KING. Thank you, Mr. Wells. Would it be fair to draw a conclusion that forward contracting is an important risk management tool throughout all agriculture production and that is a benefit to the producer, as well as a processor?

Mr. WELLS. Yes, it would be. Absolutely. It is a good program all the way around. It finds win/win solutions *versus* well, the current system, which we don't feel all the stakeholders are represented and do not have an opportunity to participate in the current system as fully as should be to find good long-term solutions.

Mr. KING. And if I might ask you to speculate a little bit here, then. If we had had this forward contracting in place, let us just say for a generation so that it would have had an opportunity to mature, and the industry had had an opportunity to mature simultaneously. I talk sometimes about economic evolution, how things take place, because of the environment that you are in. If you go back and rewind, say, 25 years into an environment that had forward contracting, how would you speculate that the milk production and processing industry could look differently or would look differently today?

Mr. WELLS. I would think it would be a much more stable system. I would think that it would be more satisfaction and less disagreement and controversy within the industry, itself. I think the industry would be more representative of consumer needs because, again, by allowing all stakeholders to participate in the solution to problems we can better focus on consumer needs. It seems like our current system is pretty well supply side focused and I think we need to represent and understand what do our consumers consider to be valuable and what do they want when they buy our products? How can we value-add our products in industry and by having the entire industry participating in solutions to our industry problems, we will be better consumer focused. I think we will be more stable, more consistent and I think it will be just a happier industry all the way around.

Mr. KING. I thank you, Mr. Wells. I thank all the panelists. Mr. Chairman, I yield back.

Mr. BOSWELL. Thank you very much. I guess many of you have discussed or made comment about having some kind of a commission to study this *versus*, perhaps, having us do it on this panel up here on this side, and I think there can be some merit to that. I am going to address this to you, Warren. How would you construct this commission? Who would be the participants in this commission? And I will let the rest of you join in as you lead off.

Mr. ERICKSON. Mr. Chairman, I believe the commission should be as diverse as possible with respect to having some processors, some producers, USDA officials and experts in the industry so that we can get different perspectives. I think it should be regionally diverse, too, because we have talked about the divisiveness that can come with the different regions pitted against each other.

Mr. BOSWELL. Well, you heard what Mr. Costa had to say before he left about their 11 month effort in California, which is a big operation out there, as we all know.

Mr. ERICKSON. Yes. And while that was not heartening, I believe that we did find some consensus today in that the USDA framework that is in place is quite complex, archaic and unresponsive, so I think in that framework, if you put this commission together, perhaps if it is diverse enough, we could come to a better conclusion.

Mr. BOSWELL. Thank you. Anybody else want to comment or add to?

Mr. REIDY. Mr. Chairman, I might just add that I think you need to have the highest level of expertise in the industry on this commission, people who truly do thoroughly understand the challenges with these Federal Milk Marketing Orders. I think, as Mr. Erickson talked about, you do need the regional representation as well as across the industry in terms of just the diversity of the production operations that we have here at the panel. I think you need to take that into mind, too. Thank you.

Mr. WELLS. From my perspective, Mr. Chairman, I would just add when the current system was put together, I don't believe that cooperatives owned or operated processing plants. Today, through evolution of time, the cooperatives do own a number of processing plants and we find ourselves competing with them more than ever before. That is again why I advocate a broader, more representative role for the entire industry in the decision making process. Cooperatives today can forward contract. We think that is a competitive advantage that they have that we proprietary processors do not have and we would like to level the playing field. And we are hoping that that commission can do that.

Mr. AHELM. Speaking of forward contracting, I think it needs to be clearly understood that it is an option, not a mandate, except we are denied the option currently. The blue ribbon committee is very important. I think it is essential that it not only reports back to Congress, but it reports also to the Secretary of Agriculture because certainly, the efforts on both venues are extremely important as far as the way it impacts dairy farmers and processors.

Mr. HITCHELL. Mr. Chairman, in light of my earlier comments, I would also say that it would be a good idea if we could find some consumer groups to participate, as well, since as we have said, without them we don't have an industry, so it would be helpful to have some consumers to be on this blue ribbon commission to let them know and have their input on how we price their milk and dairy products they consume every day.

Mr. BOSWELL. Well, thank you very much. It has been a long morning, but it is past morning. We appreciate your taking the time and coming and talking to us and you pointed out, we have got some work to do. I think it is correct to say that back in the

1985 Farm Bill a commission was established and just what came out of that I don't know, but that doesn't mean we can't give that reconsideration. So I thank you for coming; I appreciate it very much and we will be keeping in touch with you and see if we can't do something that is correct, so that will be our bill. By the rules of the Committee, the record for today's hearing will remain open for 10 days to receive additional material and supplemental responses from witnesses. Any question posted by members of this panel? This hearing of the Subcommittee of Livestock, Dairy, and Poultry is adjourned.

[Whereupon, at 1:20 p.m., the Subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

Chairman Leonard Boswell
Opening Statement
Subcommittee on Livestock, Dairy, & Poultry
Hearing to review the Federal Milk Marketing Order rulemaking procedures
April 24, 2007

I would like to thank everyone for joining me here today. I appreciate everyone taking the time to address some of the concerns in the rulemaking procedure for Federal Milk Marketing Orders (FMMO). A special thanks to our witnesses for testifying before the Committee and a special welcome to our two Iowans, Warren Erickson from my district and Douglas Wells from Mr. King's district. I very much look forward to hearing your testimony.

Since January, I have been on a crash course in dairy policy. Not having an extensive background in the dairy industry I wanted to ensure I fully understood the issues surrounding dairy. What I quickly learned was that was very challenging. The running joke I hear over and over is there are three people in DC who fully understand dairy policy; however, two are lying. With that being said, as I begun to learn more about the issues in the dairy industry and as I spoke to dairy producers in my district a reoccurring theme kept arising—the rule making process for Federal Milk Marketing Orders took too long. Often taking up to two years to get a rule approved and implemented by the USDA.

Many in the industry who have concerns over the length of the rulemaking procedures point to the California model. Granted that the California Order covers only one state, a large and important state, and the Federal Orders cover almost 70 percent of the milk marketed in the United States; the California model has a timetable that must be met. These timetables ensure that hearings are held promptly and rulings are passed and implemented in a timely fashion. One of the major complaints with the current Federal Milk Marketing Orders is that they do not currently represent the dairy market of 2007.

After reading through much of the testimony, there is consensus throughout the dairy industry that the rulemaking procedures take too long but there are varying views on how to achieve a more streamlined process. I am interested to hear about the new steps that Agricultural Marketing Service is implementing to ensure quicker turn around on rulemaking. I appreciate USDA recognizing that there has been a problem in the

amount of time that it has taken some rules to pass and be implemented but I also welcome discussion on further improvements that can be made.

Federal Milk Marketing Orders were created to assist the marketing of milk by dairy producers and have done just that for years. We must ensure that the process quick and efficient, and represents what the dairy market in 2007 looks like. As we look forward toward the 2007 Farm Bill discussion we will be looking at different proposals to change the Federal Milk Marketing Order system. One such proposal is to create a commission to review and recommend ways to streamline the system, increase its responsiveness to market forces, and ensure that it's still serving the best interest of the industry and consumers. I look forward to more conversation on this issue.

I found it interesting that the USDA acknowledges the consolidating dairy industry on the heels of last weeks hearing on the market structure of the livestock industry. They recognize that today we have considerable more dairy producers, than processors and grocers. With only ten grocer retail companies, concentration in the dairy industry is evident. There is some concern that the grocery companies, without the Federal Milk Marketing Orders, could push milk prices down to the processing industry which in turn could push lower prices down to dairy farmers. Dairy is not a commodity that can be withheld from the market until prices improve. Since dairy must be sold everyday producers are susceptible to having to sell their product regardless of the price. This is one reason why the Federal Milk Marking Orders were created—to balance competition with in the dairy industry.

I appreciate everyone taking the time to discuss the issues at hand. I welcome today to further the discussion on the Federal Milk Marketing Orders. Thank you again for joining us here today.

Agriculture Committee Republicans
Bob Goodlatte
Ranking Republican
1305 Longworth House Office Building
Washington, DC 20515, (202) 225-0029
www.agriculture.house.gov/republicans

Opening Statement of Robin Hayes
Subcommittee on Livestock, Dairy and Poultry
Hearing on Federal Milk Marketing Orders
April 24, 2007

Thank you, Mr. Chairman. I appreciate you holding this hearing today.

As you all are aware, during my Chairmanship in the previous two Congresses, dairy was under the jurisdiction of another subcommittee, so I have not had the opportunity to fully immerse myself in what is among the most complex programs under the Ag Committee's jurisdiction. I have been looking forward to this hearing as a chance to learn as much as I can about this industry, especially considering it is the only **FARM BILL** program that this subcommittee has jurisdiction over.

Now, as we get into these issues, I think it'll be pretty clear that some of us up here on the dais tend to take a free market approach while others tend to favor some level of government involvement in the market place. Where I think we will all agree is that if the government is involved, it needs to be a facilitator, not an impediment.

From what I know about the Federal Milk Marketing Order system, the industry faces some fairly cumbersome hurdles, both administrative and legislative, that only serve to hamper efforts to improve the orders for all participants.

I appreciate that USDA has acknowledged this fact and is working hard to do what they can to improve the process. I recognize also that there is a consensus among the industry that more needs to be done.

I appreciate all the witnesses for being here today to discuss this important issue.

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Opening Statement of
Agriculture Committee Chairman Collin C. Peterson
House Committee on Agriculture
Subcommittee on Livestock, Dairy and Poultry

Public Hearing to review Federal Milk Marketing Order rulemaking procedures
April 24, 2007

Thank you, Chairman Boswell for recognizing me to speak and for holding this hearing today. I also want to thank all of the witnesses for testifying here today.

Dairy policy is a very regional, very complicated part of federal farm policy. There are many different opinions on a wide range of dairy policy issues, including price support system reforms and the MILC program. We have to take a serious look at all of these important issues.

But today's hearing will give us a chance to focus attention on one component of dairy policy - the rulemaking procedures for Federal Milk Marketing Orders.

The testimony submitted by witnesses today offers many suggestions to improve the Federal Milk Marketing Orders rulemaking process. These suggestions include the establishment of deadlines to ensure timely hearings and criteria to guide hearing selection and scheduling requests. I

appreciate the witnesses for offering constructive proposals to streamline and improve the process.

As we are beginning the process of writing the Farm Bill this year, it is important for the Committee to review current policies and consider all proposals to improve dairy policy so that producers, handlers and processors can benefit from cost-effective, common sense federal dairy programs.

Chairman Boswell, thank you again for holding this hearing today on this very important issue, and I look forward to the testimony from our witnesses.

Opening Statement of Bob Goodlatte
Subcommittee on Livestock, Dairy and Poultry
Hearing on Federal Milk Marking Orders
April 24, 2007

Thank you Mr. Chairman. I have found that the easiest way to clear a room is to begin talking about dairy policy. Few markets suffer such an extreme level of government regulation. Dairymen are over regulated in just about every aspect of their business.

When we discuss dairy policy in this Subcommittee, we must always be cognizant that the slightest change can have severe repercussions. As such, it is rare for the Agriculture Committee to consider dairy proposals that are acceptable to all players.

However, as the full Committee traveled throughout the country last year, a common theme among dairy producers and processors emerged: the Federal Milk Marketing Order system needs to be more responsive!

As most of us have become painfully aware, even simple changes to federal orders can often take a year or more to accomplish. For example, dairymen in my region of the country petitioned for a change in October of 2005 to adjust transportation credits in the Southeast and Appalachian orders. USDA proceeded to consider this proposal on an expedited basis. A year later, the Department published an interim rule that covered only a portion of the original petition. As we sit here today, this rulemaking is still open and the problem for my dairymen has yet to be resolved.

It would be easy to sit here and blame USDA for the length and complexity of this process. If we did that however, we would be ignoring the fact that USDA is simply abiding by the laws our predecessors created. Likewise, we would be ignoring the affect the various industry participants have in slowing down the process when it suits them to do so.

Unlike other Federal rulemaking procedures that are regulated under the Administrative Procedures Act, Federal Milk Marketing Order rulemaking is regulated by the arcane procedures of the Agricultural Marketing Agreement Act. USDA has some discretion to improve their internal management of the process, and we will hear today that this is something the USDA dairy program is committed to doing. Unfortunately, that will only get us so far. The rest needs to be done by the Members of this Committee.

As we begin this process, we are fortunate that we have a successful model that we can evaluate. There are many aspects of the California system that we could incorporate into a federal system which is encouraging. If we are successful in capturing the best of both systems, we may actually have finally done something good for dairy.

Thank you again, Mr. Chairman. I yield back.

Statement of Lloyd Day, Administrator
Agricultural Marketing Service
U.S. Department of Agriculture

Before the

House Committee on Agriculture
Subcommittee on Livestock, Dairy, and Poultry
April 24, 2007

Mr. Chairman, and members of the Subcommittee, good morning and thank you for the invitation to appear before you today. Accompanying me is Dana Coale, Deputy Administrator, AMS Dairy Programs. My remarks will provide a brief overview of the Federal Milk Marketing Order system including a review of Federal Milk Marketing Order rulemaking procedures.

Dairy Market Situation

Although the dairy industry is facing increasing feed costs, slowed increases in milk production and robust demand are resulting in stronger milk prices. Through February of 2007, estimated U.S. milk production has increased only slightly over 2006. In January and February of this year 29.9 billion pounds of milk were produced, growing just under one percent over the previous year. The most recent estimates show limited increases in cow numbers. The 9.1 million cow herd is just 0.4 percent larger than at the same time last year. Production per cow in February of this year was unchanged from 2006 at 1,567 pounds per cow.

Commercial disappearance of milk in January was estimated at nearly 15 billion pounds, up over 5 percent from 2006. However, with tightening milk supplies,

production of dairy products is already slowing and so far in 2007 production of nonfat dry milk and skim milk powders is falling below 2006 levels. As a result, dairy product prices have been increasing as have milk prices. The average Federal order uniform milk price of $14.70 per hundredweight reported for February of this year is a year-over-year increase of more than 8 percent.

Internationally, the U.S. has become a major exporter of nonfat milk products. Though the European Union, New Zealand, and Australia have long been the major players, the U.S. has been the leading exporter since 2005. The U.S. is expected to remain the leader through 2007 with an expected 295,000 metric tons exported, an increase of 1.7% over 2006 levels, even as the overall market is expected to contract slightly. The tight market has led to higher international prices, which in turn have boosted domestic prices.

Federal Milk Marketing Order Program

AMS administers, among other programs, the Federal milk marketing order program. Federal milk marketing orders are authorized by the Agricultural Marketing Agreement Act of 1937, as amended. The Act authorizes the Secretary of Agriculture "to establish and maintain such orderly marketing conditions ...as will provide, in the interests of producers and consumers, an orderly flow of the supply ...to avoid unreasonable fluctuations in supplies and prices." (7 U.S.C 602)

Milk Marketing Orders are funded through user fees, with AMS Federal oversight provided through mandatory funds. The 10 Federal orders cover a majority of the U.S

and are a major part of milk marketing in the United States. Receipts of producer milk by handlers regulated under Federal milk marketing orders totaled 120.6 billion pounds in 2006. Federal order receipts were about 67 percent of total US milk marketings of 180.8 billion pounds. More than 90 percent of U.S. milk is marketed under either Federal orders or under similar regulations issued by State governments (California alone regulated over 21 percent of U.S. milk marketings in 2006). The number of farmers (producers) delivering milk to handlers regulated by Federal milk marketing orders each month in 2006 averaged 52,725, or about 85 percent of the 61,990 licensed dairy herds (NASS – Milk Production Feb. 2007).

What Federal Orders Do

The Federal milk marketing order system facilitates the marketing of milk by dairy farmers and their cooperative associations. Federal orders regulate handlers who buy milk from farmers and their cooperatives for use in fluid milk products. The Federal order under which a handler is regulated generally depends on where a handler sells fluid milk products. The defined Federal marketing areas are areas in which fluid milk handlers compete with each other for fluid milk sales. With minor exceptions, handlers do not have to be located in a marketing area to be regulated.

Federal orders set minimum prices paid by regulated handlers for milk according to how it is used. Federal order minimum prices for milk in manufacturing uses are based on pricing formulas that reflect the wholesale prices of manufactured dairy products, manufacturing costs, and milk-to-product conversion factors. Minimum fluid (Class I)

milk prices are based on minimum prices for milk in manufacturing uses plus differentials that reflect the additional costs of marketing milk for fluid uses at different locations. Market-generated Class I prices generally exceed Federal order minimum Class I prices, the differences being referred to as over-order premiums. Over-order premiums are regularly generated for milk used in other classes (uses) as well.

Dairy farmers who supply enough milk to a market's fluid handlers to meet an order's performance standards share in the revenue of all milk sales under the order. Regardless of how an individual dairy farmer's milk is used, the farmer receives at least the blend or market average minimum price for milk sold in all classes. Blend prices received by dairy farmers are adjusted to the location of delivery, and thus reflect some of the additional costs of marketing milk for fluid use compared to manufacturing uses. Federal milk orders provide a structured means of sharing the benefits and compensating for the additional costs of supplying the Class I needs of a market and prevent dairy farmers from being subject to undue pressures from buyers in the marketing of a highly perishable product.

Milk marketing orders also benefit dairy farmers, manufacturers and processors and others in the marketing chain in other ways. In addition to the market information made available by Dairy Market News, the Federal milk order program amasses a considerable amount of data on producer numbers, milk marketings, prices, fluid milk sales, and dairy product production that AMS publishes for the use of all market participants. These data are made available over the internet and thus are more current and accessible than ever

before. Much of the data disseminated are audited by employees in our Market Administrator offices.

A milk market administrator administers each order. The duties performed by the market administrator and staff are specified in each order. Each month they compute and publish class and uniform prices as well as other required prices. The staff verifies each handler's reports and that their payments are correct and timely through an audit program.

The market administrator and staff prepare statistics and information concerning operations under the order, keep records and books that clearly reflect the transactions provided for in the order, and disseminate information to the public. The market administrator and staff also receive and investigate any complaints of violations of the order. Market administrator and staff expenses are paid from an administrative fund derived through assessments per hundredweight of milk pooled by regulated handlers. Most of the orders also provide for a marketing service payment per hundredweight which covers the expense of providing market information and for the verification of weights, sampling, and testing of milk received from producers (farmers) who are not members of qualified cooperatives that are performing such services. The cost of these services is borne by producers.

What Federal Orders Don't Do

The Federal milk marketing order program is a marketing program. Although the marketing order program is not a price or income support program, each of the orders establishes minimum prices, based upon supply and demand in the market place, paid by regulated handlers for milk according to how it is used. USDA operates the Milk Price Support Program and the Milk Income Loss Contract (MILC) Program for price and income support purposes.

Federal milk orders do not regulate dairy farmers. Marketing orders regulate the activities of milk handlers. Dairy farmers are able to produce as much milk as they wish and they can sell to any handler who is willing to buy their milk.

Federal orders do not guarantee a market for a farmer's milk. Farmers must find their own market and must arrange for the delivery of their milk to the handlers and bear those marketing costs.

Federal Milk Marketing Orders Remain an Important Tool for Dairy Farmers

First authorized in 1937, milk marketing orders today remain an important tool for dairy farmers. Although the market has changed since that time, many of the marketing conditions that precipitated the passage of the Act exist today. While dairy farmers and their cooperatives continue to grow in size and have integrated forward into dairy product manufacturing, the fluid milk processing industry continues to become more

concentrated. The ratio of dairy farmers to fluid milk processors continues to remain high today.

Further up the marketing chain, the grocery industry is also highly concentrated. Absent milk marketing orders, the potential exists to push lower milk prices down to handlers who in turn could push lower prices down to dairy farmers to below sustainable long-run average cost levels. The perishable nature of the raw farm milk sets up a condition of farmer (producer) vulnerability to handler market, which unlike storable commodities cannot be withheld from the market in an effort to gain a better price; Federal milk orders help balance the competition between the many dairy farmers (sellers) and the relatively few fluid milk processors (buyers).

Federal Order Rulemaking Process

The Federal order rulemaking process has received significant attention recently by all sectors of the industry regarding the length of time involved to accomplish regulatory changes.

The Agricultural Marketing Agreement Act of 1937, as amended, requires that formal rulemaking procedures be used to make changes to a Federal milk marketing order. The process is extensive and time consuming, but provides for *maximum industry participation and transparency.* The industry offers proposals, provides testimony in support of or in opposition to proposals and may cross-examine witnesses at public hearings before an Administrative Law Judge, submits briefs and proposed findings of

facts, comments on recommended decisions, and producers approve final decisions through referendums before any changes to an order are effective.

AMS is aware of the concern about timely decisions and in response undertook an extensive internal review of its part of the process and developed several new rulemaking initiatives and customer service standards. During this process, AMS consulted with other organizations, including the California Department of Agriculture, to determine best practices that could be incorporated into the Federal rulemaking process. Our goal was to improve timeliness while maintaining transparency and the opportunity for public involvement that currently exists. Some of the steps initiated by AMS include:

- Having meetings to discuss issues with interested parties before proposals are submitted.
- Holding pre-hearing information sessions to discuss proposals received with interested parties before *ex parte* rulemaking restrictions apply.
- Developing supplemental rules of practice to better define public input timelines once the formal rulemaking process begins.
- Procuring the services of court reporters in terms of "best value" rather than lowest cost to reduce transcript delivery times and improve their quality and accuracy.

Under the new customer service standards, we are planning to have amendments issued within 14 months for any non-emergency rulemaking proceeding. This process would allow three months in total for public participation. In situations when emergency marketing conditions warrant the omission of a recommended decision, the Department could move from a hearing to final amendments in 10 months or less. These new

standards are reducing the amendatory time from more than two years to around one year.

We have had extensive discussions with the industry regarding the time frames necessary for ensuring sound, reasonable decisions that allow maximum public participation and have concluded that our revised process will yield better results than a mandated time frame. Under a mandated time frame, all decisions are allowed equivalent time even though the rulemaking proceedings may differ significantly in complexity, scope, and the number of interested parties involved (e.g., proceedings involving more than one order, addressing a significant national issue, or that are highly controversial).

In addition, urgent issues that arise, which are extremely important to maintaining orderly marketing conditions would be placed in line with ongoing proceedings. This would not be beneficial to the industry.

One example of such a situation involved changes to the Southeastern orders as a result of the hurricanes. Disorderly marketing conditions were developing as a result of the devastation in the region. Therefore, working together with industry, USDA held a hearing on October 7, 2004, allowed public participation and briefing, held a producer vote, and implemented changes on December 10—a mere two months after the hearing. While this was an unusual situation, I believe it is important to emphasize that when the industry is unified in their position and disorderly marketing occurs, things can happen quickly while still allowing important public participation.

Of course, situations like this result in other decisions being delayed because of limited resources. The decisions being delayed are typically those that are not of an urgent nature to the industry or that have been implemented on an interim basis. If mandated time frames were implemented, USDA would no longer have discretion to expedite certain issues that are of utmost importance to the industry.

Another key concern that we have with mandated time frames is with regard to litigation. Decisions issued by USDA must withstand scrutiny in the legal system. This appears to be increasingly important as more decisions are challenged when a party fails to prevail on an issue. If mandated time frames were implemented, highly controversial decisions may not be as sound, reasonable and complete as they are today, potentially resulting in further litigation. Ultimately, this may result in further delays in implementing changes - a potential consequence of the mandated time frames. It is vitally important that we have time to develop the best, sound, and reasonable decisions possible based upon the record evidence to withstand such challenges. Nonetheless, as already noted, AMS is committed to improving the process.

Changing Market Conditions

Again, while some of the marketing conditions that existed when milk marketing orders were first authorized still exist today, other marketing conditions have changed and Congress, the industry, and the Administration have worked to keep the program attuned to the marketing conditions of today. Since the authorizing legislation was passed in

1937, the Act has been amended numerous times to add additional authorities when needed. Authorities in the Act that were no longer needed or were no longer considered economically efficient were removed or allowed to expire. One example of this is the authority for Class I base plans that was allowed to expire in the early 1970s.

The Federal milk marketing order program has continually changed to reflect relevant marketing conditions facing the dairy industry. Since 2000, AMS has undertaken 19 rulemakings to amend Federal orders involving more than 62 publications in the Federal Register. Of these rulemakings, 14 have been finalized. Major changes have included:

- Consolidating and expansion of milk marketing areas as handler competitive areas increased in geographic scope
- Adopting of a uniform classification of products as they began to move more easily around the country
- Tying all milk prices to manufactured product wholesale prices when the competitive pay price series was becoming suspect as an indicator of the value of milk
- Altering the pricing of nonfat dry milk used in the production of reconstituted milk to reflect the expanded sourcing of such product
- And, adopting a national Class I pricing surface to stabilize plant pricing as marketing conditions changed to cause plants to shift among areas of regulation.

Finally, I would like to again stress that Federal milk marketing orders today remain an important tool for dairy farmers. They are not a price support program or an income support program. AMS will continue to work with all sectors of the U.S. dairy industry

to administer Federal milk marketing orders so that dairy farmers are assured of a reasonable minimum price for their milk, and consumers are assured an adequate supply of fluid milk to meet their needs throughout the year.

This concludes my statement, Mr. Chairman. I would be pleased to respond to questions.

Questions And Answers On Federal Milk Marketing Orders

United States Department of Agriculture
Agricultural Marketing Service
Dairy Division

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Slightly Revised March 1996

QUESTIONS AND ANSWERS ON FEDERAL MILK MARKETING ORDERS

INTRODUCTION

To understand how Federal orders contribute to market stabilization, it is helpful to take a look at the conditions which brought them into being, their objectives, how they are organized and how they operate. These orders are now operating in most of the fluid milk marketing areas of the United States and cover about 70 percent of all U.S. milk marketings (see Appendix B, Measures Of Growth In Federal Milk Order Markets, 1950-95).

Fluid milk (chiefly used as a beverage) flows from dairy farmers to consumers through a vast channel work of modern production, processing and distribution. The marketing system on which this flow of milk depends is fast and highly organized. On a daily schedule, fresh milk flows from farms through local, regional and national processors and distributors, along urban, suburban and rural delivery routes to reach consumers whose appetites also operate on a daily schedule.

Because this supply of milk cannot easily be turned on and off to fit the supply of milk to the demand, the marketing system often runs into trouble with milk prices. At times, marketing conditions can result in wildly fluctuating prices which work unnecessary hardship both on those who depend on milk for a living and those who depend on it for food.

Federal orders are used to stabilize conditions for fluid milk–to make the buying and selling of fluid milk an orderly process upon which dairy farmers, milk dealers and consumers alike can depend.

At one time, dairy farmers delivered milk to homes in the nearby town. The matter of a "reasonable price" was settled through simple agreements between farmers and their customers. But as marketing methods developed, farmers became separated from consumers by distributors and wholesalers who set prices for both farmers and consumers.

The effect of this change was not only to put farmers in a more difficult bargaining position but also to make the pricing of milk to farmers subject to serious new elements of instability.

Farmers observed that prices became unstable chiefly because of fresh milk supplies in excess of daily consumer purchases. Yet, they also observed that

some reserve milk was quite necessary to any well-supplied market. And because production varied widely from season to season, this reserve, consequently, was greater during the season of high production.

Farmers found that the presence of reserve milk in a highly competitive market tended to result in lower prices and eventually in lower production. Yet, when reserve supplies dwindled, temporary shortages resulted with upward pressures on prices.

Under this situation of price instability, farmers in many markets during past years found themselves virtually powerless to prevent unreasonable and harmful price manipulation. Dealers, driven by sharply competitive conditions, often engaged in "price wars," with lower prices being passed back to farmers.

Consumers pay the final cost of disruption in the form of higher prices when farm milk supplies decline.

As early as 1900, erratic and widely fluctuating prices had become a serious and characteristic problem of fluid milk markets. Following World War I, many farmers formed cooperatives in an effort to stabilize prices through collective bargaining with proprietary handlers. But these bargaining arrangements frequently were disrupted by a minority of dairy farmers and dealers who continued to trade in milk without regard to the bargaining agreements entered into by the majority.

When the depression of the early 1930's broke down most bargaining arrangements and caused farm milk prices to collapse, farmers turned to Government for help. Local and State regulatory agencies were established in all parts of the Nation and were effective in stabilizing prices. But only Federal authority was broad enough in scope to regulate markets where part of the milk entered into interstate commerce.

Federal authority to regulate the handling of milk was first provided in the Agricultural Adjustment Act of 1933. The Federal orders of today, however, are based on the Agricultural Marketing Agreement Act of 1937 (the Act), as amended, which sets out in detail the authority granted earlier.

Under this authority, the Secretary of Agriculture is empowered to help stabilize market conditions by issuing Federal orders (regulations enforceable by law) which apply to handlers of milk and its products. The Secretary of Agriculture also can enter into marketing agreements with processors, producers, associations of producers and others engaged in the handling of milk as a further instrument of market stabilization. Marketing agreements, however, have not been issued for many years. Consequently, the explanations in the following questions

and answers relate generally to Federal orders rather than to marketing agreements.

1. What is a Federal milk marketing order?

It is a regulation issued by the Secretary of Agriculture which places certain requirements on the first buyers or handlers of milk from dairy farmers.

a. It requires that handlers of milk for a marketing area pay not less than certain minimum prices established according to how the milk is utilized. These prices are established under the order after a public hearing at which evidence is received on the supply and demand conditions for milk in the market. A milk order, including the pricing provisions and all other provisions, becomes effective only after approval by dairy farmers.

b. It requires that payments for milk be pooled and paid to individual farmers or cooperative associations of farmers on the basis of a uniform or average price.

c. The provisions that an order may include are limited by the statute.

2. What is the scope of the Federal milk order program?

The Federal milk order program is essentially a national program with producers located in each of the 48 contiguous States delivering milk to plants regulated by milk orders. In about three-fourths of the States, over 90 percent of the Grade A milk is shipped to plants regulated under Federal orders.

The number of Federal orders has been reduced by more than one-half from the peak of 83 orders in the early 1960's in response to widening areas of milk procurement and distribution. Over the same period, the quantity of milk regulated under Federal milk orders has about doubled. About 75 percent of the Grade A milk and around 70 percent of all milk marketed in the country were being marketed under milk orders in the early 1990's.

3. What are the objectives of a Federal order?

Federal orders operate to:

a. Assist farmers in developing steady, dependable markets by providing prices for their milk which are reasonable in relation to economic conditions.

b. Assure consumers at all times of adequate supplies of pure and wholesome milk at reasonable prices.

They operate to correct conditions of price instability and needless fluctuations in price which:

a. Give unwarranted "stop" and "go" signals to production.

b. Result in unnecessarily depressed prices to farmers that do not properly reflect supply and demand conditions.

c. Jeopardize the quality of the milk and the dependability of its supply.

Milk orders also supervise the terms of trade in milk markets in such a manner to achieve more equality in the market power of producers as compared to that of milk processors.

4. How does a Federal order attain its objectives?

It bolsters market conditions with a legal framework of rules and procedures on which orderly marketing activities can be based to the benefit of all parties concerned. These rules and procedures serve to:

a. Give farmers, milk handlers and the public an active voice in determining minimum farm milk prices through a public hearing procedure.

b. Establish minimum prices to fluid milk buyers that assure farmers as much for their milk as general supply and demand conditions in the market warrant and assure the market of adequate current and future supplies of milk.

c. Provide for the orderly marketing of reserve milk through a pricing method based on the uses for which milk is sold and a payment method by which farmers are assured uniform prices for the milk they deliver to the market or to individual handlers in the market.

d. Reduce the dangers of unwarranted and harmful fluctuation of prices paid to farmers.

e. Allow for impartial audit of handlers' records to insure payments to dairy farmers and to verify reported utilization of milk.

f. Assure farmers of accurate weighing, testing, classification and accounting for milk.

g. Make available information on the handling of milk in the marketing area so as to enable interested parties to evaluate the market situation.

5. Who administers the Federal order program?

Supervisory administration of the Federal order program is carried out by the Dairy Division, Agricultural Marketing Service, U.S. Department of Agriculture (USDA), Washington, D.C. Each individual order is administered locally by a market administrator appointed by the Secretary of Agriculture. The market administrator employs a staff of auditors, agricultural economists and laboratory, data processing and clerical personnel.

6. What kind of milk is covered by Federal orders?

Federal orders are primarily instruments for stabilizing marketing conditions for "fluid milk" and, for this reason, they apply to milk which is produced under sanitary inspection for sale in fluid form. Such milk is often known as "Grade A" or milk eligible for fluid use.

State and local health regulations largely determine for each market the uses of milk which require "Grade A" supplies. In most markets, this category includes fluid whole, lowfat and skim milk, flavored milk drinks and buttermilk. In a few markets, additional uses are included, such as fluid cream and cultured cream products.

7. Who is regulated by an order?

Milk handlers are the only persons regulated. They usually are defined as anyone who handles Grade A milk from dairy farmers for distribution in the marketing area.

The order requires that when a milk handler operating under the order purchases milk from a dairy farmer, such handler must pay at least the minimum price, make accurate weights and tests and account properly for the way the milk is used.

The order does not control from whom the handler shall buy, to whom the handler shall sell, how much the handler should buy or sell or at what prices the handler may sell.

8. Are dairy farmers controlled in any way?

No. They may produce and sell any amount of milk under a Federal order. So far as the order is concerned, any dairy farmer who can find an outlet with a

regulated handler in the market is entitled to the benefits of the order. Certain provisions in orders, however, may influence producers as they make production and marketing decisions. For example, seasonal incentive payment plans provide price incentives which encourage more even production during the year.

9. Does a marketing order regulate retail prices?

No. The Agricultural Marketing Agreement Act of 1937, authorizing Federal orders, does not authorize setting of retail milk prices.

10. How is milk priced under an order?

It is priced under a classified pricing plan which divides milk received by handlers into classes according to use. The plan provides an appropriate minimum price which handlers must pay producers for milk in each class.

Milk sold for consumption in fluid form is included in Class I. This class includes fluid whole milk, fluid lowfat and skim milk, and flavored milk and milk drinks. Milk in Class I receives the highest price in the market. Changes in this price are the major means used to obtain an appropriate balance between supplies and sales of fluid milk plus necessary reserves.

Milk used in manufactured dairy products is included in two classes. Class II milk is used in soft manufactured products, such as cream products, cottage cheese and ice cream, and has a lower price. Class III milk is used in hard manufactured products, such as butter and Cheddar cheese. Class III also includes milk used in nonfat dry milk in 11 orders, while Class III-A is milk used in nonfat dry milk in 22 orders. The lowest price is for Class III and Class III-A.

A well-supplied market requires a daily reserve supply of fluid milk to take care of daily fluctuations in demand. In addition, there are significant seasonal variations in the volume of milk produced which influence the quantity of reserve supplies carried by a market. Milk delivered to the market in excess of sales in the highest priced class is placed in a lower priced class or classes. By pricing reserve milk supplies, the classified pricing plan prevents such supplies from depressing the price of milk to dairy farmers to the point where the supply for a market may become endangered. It also results in greater market stability, without the price fluctuations that short-time changes in supply and demand could bring about.

The classified pricing plan also contributes to the orderly marketing of milk by pricing reserve milk at a level commensurate with its value in manufactured dairy products. Thus, reserve supplies are priced at a level related to their value

to the handler and at a level at which handlers will be willing to accept such excess milk.

The classified pricing plan recognizes that it is more costly to produce and market milk for fluid use than for milk that can only be used for manufacturing such products as butter, cheese and nonfat dry milk. This cost difference exists because:

a. Additional expenditures must be made for fluid milk to comply with the rigid sanitary standards which apply to Grade A milk.

b. Milk in fluid form, which is perishable in nature, usually must be transported relatively long distances from production areas to market centers.

11. How are specific price levels determined?

The Agricultural Marketing Agreement Act of 1937 requires that minimum farm prices for milk be established at levels which will:

a. Reasonably reflect economic conditions affecting the supply and demand for milk (such as the price of feeds).

b. Assure an adequate supply of pure and wholesome milk for the market.

c. Assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs.

d. Be in the public interest.

In short, the Act requires the establishment of minimum prices which will equate the supply of milk with the demand in regulated marketing areas after making provisions for necessary reserve supplies.

The price levels generally are set by means of price formulas which allow the minimum prices to change automatically along with certain changes in the market conditions for fluid milk. This is done because conditions which affect milk prices may change frequently and rapidly. Every season of the year brings changes which might render a fixed, flat price out of date.

In Federal order markets, class prices are based in most cases on the average price received by farmers for milk of manufacturing grade (Grade B) in the Minnesota-Wisconsin area (the M-W price). The Class I price is the M-W price

plus a specified Class I differential that reflects the costs of transporting milk for fluid use, the added costs of marketing milk going into fluid milk products and the higher costs of producing Grade A milk. These Class I differentials are designed to relate the supply of milk for fluid use in the regulated markets to the demand for it in those markets.

Prices for milk used in Class II and Class III also are fixed on a formula basis which relates the price for each use of milk to the average price received by Minnesota and Wisconsin farmers for manufacturing grade milk. The Class II price in all orders is the M-W price plus a fixed differential of 30 cents per hundredweight. The Class III price in most cases is the M-W price. Class II prices are essentially the same in all orders, as are Class III prices. In orders with Class III-A pricing, the Class III-A price is determined through the use of a product-price formula and is based on wholesale prices of nonfat dry milk.

Advance Class I and Class II pricing procedures are used in Federal order markets to provide handlers with an announced price in advance of the month to which it applies. Both Class I and Class II prices are based on the M-W price for the second preceding month. Therefore, handlers know these class prices nearly a month before the month that the prices apply.

12. What is the Minnesota-Wisconsin (M-W) manufacturing grade milk price?

The M-W price is the average price received by farmers in Minnesota-Wisconsin for manufacturing grade milk delivered to plants before hauling costs and producer assessments are deducted. These plants are unregulated and therefore the M-W price is a competitive pay price determined in the marketplace. The M-W price is representative of the price paid for nearly half of the manufacturing grade milk in the country.

Each plant operator determines the milk price to be paid to farmers after considering the proceeds from the sale of products manufactured, the costs of operation and the competition. The M-W price is based on data collected by the USDA's National Agricultural Statistics Service from plants that purchase about 80 percent of all the manufacturing grade milk marketed in the two States. The base-month M-W price is updated to the current month for use in milk orders by a product-price formula.

13. How is the uniform or blend price to farmers computed?

To compute the uniform or blend price, the market administrator gets information from handlers at the end of each monthly delivery period telling how much milk they handled during the month and how much went into each use of milk.

From this information, the market administrator can determine how much of the total milk brought into the market belongs in each class.

The market administrator multiplies the minimum price for each class by the amount of milk in that class to get the total value of milk in each class. The total value of milk for individual classes is added to get the total value for all milk marketed during the period. The total value for all milk is divided by the total pounds of milk received from dairy farmers to obtain the average or pool price of milk for the market--in effect, a weighted average price. Milk handlers then are required to pay not less than this uniform pool price for all the milk they have received from each farmer.

The uniform or blend price may be computed separately for each handler or it may be computed for all of the handlers in the market depending on whether the market has an individual handler pool or a marketwide pool (see question 35(e)).

14. How are farmers paid under an order?

Handlers make payment to producers or cooperatives. Farmers receive milk checks once or twice monthly. Under Federal orders, payment may not be less than the uniform price as announced each month by the market administrator, except to producers who receive payment from the cooperative to which they belong.

15. How is multiple component pricing (MCP) used in milk orders?

While most orders provide that blend prices to dairy farmers are adjusted based on the butterfat content of their milk, an increasing number of orders are adopting multiple component pricing under which prices are based on both the butterfat and nonfat solids (or protein) in the milk. Historically, most of the value in milk was associated with the butterfat, but the nonfat milk solids, including protein, now carry most of the value.

Some orders are making adjustments to producer payments based on the somatic cell count of the producers' milk. By affecting the quality of the protein and butterfat components of milk, somatic cells affect the yields of some manufactured dairy products, such as Cheddar cheese, and the taste, quality and keeping characteristics of all milk products.

Multiple component pricing has been used primarily in markets with considerable manufacturing of dairy products, since it is the processors of such products that gain the most benefit from the higher nonfat solids in milk. MCP has not been adopted on Class I milk (milk used in fluid products) nor in markets where

most of the milk is used in Class I. This is because consumers generally have been unwilling to pay for extra protein in fluid milk products, which means that fluid processors have been unable to obtain the added cost of higher protein milk in the marketplace.

16. How are Federal orders enforced?

Legal action may be instituted through the Justice Department in the Federal courts to enforce a Federal order.

If a market administrator discovers that a milk handler is not complying with the terms of the order, the market administrator informs the handler of this fact and asks the handler to make the necessary corrections. If the milk handler complies with the request promptly, the matter is terminated at that point.

If, however, the violation is not rectified promptly, the market administrator informs USDA. This can lead to injunctive action by the courts or to the imposition of civil or criminal penalties, depending on the nature of the violation.

17. Has the legality of orders ever been tested?

Yes. The Agricultural Marketing Agreement Act of 1937 and the orders issued under it have been tested in the courts many times. In several cases, the Supreme Court of the United States very thoroughly reviewed the Agricultural Marketing Agreement Act of 1937 and Federal orders issued under that authority. The court gave its approval to the law and to such orders.

The Act specifically provides that any handler regulated by a Federal order may petition the Secretary of Agriculture for a review of any provision of the order or obligation imposed by it. Any ruling on the petition adverse to a handler is reviewable by the Federal Courts.

Individual provisions of orders and procedures taken under the authority of orders have been reviewed many times by the courts. The constitutional power of the Federal Government to regulate the handling of milk which is in the current of interstate commerce or which burdens, obstructs or affects interstate commerce in milk has been established.

18. How are the operating costs of Federal orders defrayed?

Milk handlers are assessed in accordance with the quantity of milk they receive or handle. The amount of the assessment varies under different orders and at different times. Generally, it ranges from 2 to 5 cents per hundredweight of the milk received by the handlers from producers.

19. Are Federal orders a substitute for producer cooperatives?

No. A producer cooperative continues to perform all of its functions under a Federal order. At public hearings, cooperatives present testimony and factual information in support of, or in opposition to, proposed changes in the order.

Whenever the cooperative performs any of the physical functions connected with marketing, it will continue to perform these functions in the same manner as before the regulation.

Since orders are a mechanism for market stabilization only, they cannot perform many of the functions of cooperatives. Cooperatives guarantee markets for their producers' milk and secure the most beneficial utilization of milk. Cooperatives perform many of the other marketing functions such as procurement of supplies and economical transportation of milk.

20. Does a marketing order guarantee an adequate income to all farmers?

No. The marketing order program provides prices which will result in an adequate supply of pure and wholesome milk for each marketing area and it prevents prices from fluctuating wildly without regard to general economic conditions. In the long run, however, the Secretary of Agriculture must assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs.

21. Are milk handlers required to buy from certain farmers?

No. The milk order does not require a milk handler to purchase milk from any group of farmers or to purchase milk in any specified quantities. All it requires is that the milk handler conforms to the requirements of the order in paying for the milk received.

22. What is a milk marketing agreement?

It is an agreement entered into by milk handlers and the Secretary of Agriculture. Although an agreement is authorized by the Agricultural Marketing Agreement Act of 1937, it is rarely issued in connection with milk regulation. An agreement may be issued separately or in conjunction with an order. In the latter case, the agreement would be in terms identical with those of the order. If an agreement without an order were to be issued, the terms would not need to be limited to those specified for orders; the terms provided, however, would be of a kind which carry out the policy of the Act. They would be binding only on those signing the agreement.

23. Are orders adapted to individual market conditions?

In the past, milk orders generally have been tailored to individual local milk markets. Over time, however, the procurement and marketing of milk and dairy products have become more regional and national in scope. Consequently, markets for milk have become much broader in scope. This is reflected in the size of marketing areas where milk is regulated by a single order. Some of these areas encompass whole States and even territory in several States. The flow of milk from farm to consumer, however, may extend even beyond the boundaries of these broader areas. For that reason, a change in one order--particularly a change in price--affects supply-demand balance in other markets unless related changes are made in the other orders. Many of today's marketing problems must be viewed in the perspective of the national milk supply and the total demand for milk in the country.

24. May an order be issued for any market?

Yes, if it can be shown that:

a. The handling of milk is in the current of interstate commerce or where such handling burdens, obstructs or affects interstate commerce in milk.

b. Marketing or price conditions are such that an order is necessary or feasible to correct such conditions.

25. How is action on establishing an order first started?

An order is generally initiated when dairy farmers, through their cooperative associations, petition the Secretary of Agriculture to undertake the regulation of milk prices in a local marketing area. Upon receiving such a petition, the Secretary orders a preliminary investigation of the facts and circumstances in the market which might indicate the need and feasibility of issuing a marketing order.

If it appears from the preliminary investigation that an order might be necessary and feasible and might tend to carry out the declared policy of the Agricultural Marketing Agreement Act of 1937, a notice of a public hearing is issued. At the hearing, all interested parties, including producers, consumers and milk dealers, are given an opportunity to present facts and views on the proposed order and its provisions.

26. What are the procedures to be followed before an order can be issued?

Following the petition, preliminary investigation and hearing mentioned above, a "recommended decision and order" then will be issued. The recommended

decision and order are based on the facts presented at the public hearing. It represents a preliminary statement of the reasons for the issuance of an order. It also outlines a recommended order and gives reasons for each of the terms contained in it.

A period of time is allowed for interested persons to review the recommended order and to file exceptions.

After the comments are reviewed, any changes in the proposed order which seem necessary or desirable are made. Then, a final decision and final order are issued by the Secretary of Agriculture. These are presented to dairy farmers who are given an opportunity to vote on whether or not the order will be made effective. If the order contains a marketwide pool, the law provides that at least two-thirds of the producers selling milk in the marketing area must approve the final order before it may be issued. A favorable vote by three-fourths of the producers is necessary if the order provides for an individual handler pool. Producer approval is ascertained by a referendum and the percentage of approval is determined in relation to the number of producers who vote.

27. Why are these procedures necessary in establishing an order?

The marketing of fluid milk is a very complex business. It has an important impact on dairy farmers, milk dealers and the general public. In a democratic society, it is imperative that protection be afforded to all affected groups when any action of Government is contemplated. To assure this protection, procedural safeguards of notice, hearing, recommended decision, final decision, producer approval and final notice of the issuance of an order are necessary.

28. What groundwork must be laid before an order is issued?

Facts relating to general economic conditions and to prices, supplies and sales of milk must be obtained. Also needed is information regarding the extent to which the handling of milk in the proposed marketing area is in the current of interstate commerce or directly burdens, obstructs or affects interstate commerce. The need for an order and the conditions which will be corrected or relieved by the order also must be explained.

All of this material must be presented at a public hearing. Consequently, it is necessary that witnesses be prepared. Adequate preparation requires the services of experts in marketing, economics and statistics. Moreover, when a petition is made to the Secretary of Agriculture to institute an order in a market which has not been under regulation, it is usually required that a proposed Federal order be furnished. This would set forth in detail all of the terms and conditions which, in the opinion of the proponents, are necessary or desirable. The drafting of such a proposed order usually requires expert help from marketing specialists.

29. Does the Government provide any help in laying the groundwork?

It is not possible ordinarily for USDA to furnish personnel directly for the purpose of obtaining necessary background facts and information or for the purpose of drafting a proposed order for a new market. Within the limits of its personnel, USDA endeavors to meet with interested parties and furnish advice on the type and kind of information which will be necessary and possible sources for securing it. Expert nongovernmental help to assist in laying the groundwork for a Federal order generally is necessary.

Many Government agencies are able to contribute help in the preparation of a hearing. State Departments of Agriculture, State extension workers, State Departments of Health, and Departments of Economics and Agricultural Economics at State universities frequently provide information which is necessary background for marketing order purposes. Persons interested in developing the necessary material should communicate with these agencies for whatever help or information they can furnish.

30. How soon after a petition is entered will an order be issued?

The time between the receipt of a petition for an order and its issuance varies greatly. It depends on the availability of background information, the difficulties of the problem to be dealt with, the adequacy of the proposed order which accompanied the petition and the availability of USDA personnel to deal with it.

31. How are orders changed after they have been issued?

Whenever the possibility of improvement or changed circumstances require it, milk orders are changed by amendment. Approximately the same procedures are used in changing milk orders as are used when the orders are issued.

In the case of amendments to orders already issued, procedures may be somewhat shortened because of a shorter length of time for notice of hearing and exceptions to recommended decisions. The volume of analytical and review work may be smaller also.

A hearing to amend an order may be called by the Secretary of Agriculture whenever the Secretary feels an amendment to the order is necessary to carry out the declared policy of the Act. An amendment hearing may be requested by handlers, producers or other interested parties. The Agriculture and Consumer Protection Act of 1973 requires the Secretary to convene a hearing if requested by one-third or more of the market's producers, unless a decision on a similar proposed amendment was issued within 90 days of the request, or unless the amendment cannot legally be made. Except when voting on an advertising and

promotion program, producers must accept or reject the entire order as proposed, whether new or amended.

32. Can orders be voted out after being in effect?

Yes. A milk marketing order must be ended when the Secretary of Agriculture determines that its termination is favored by a majority of the dairy farmers who deliver more than 50 percent of the milk to the market. It may also be ended if the Secretary finds that the order either obstructs or does not tend to carry out the declared policy of the Agricultural Marketing Agreement Act of 1937.

33. In what way is the approval of dairy farmers determined?

The Secretary of Agriculture is authorized to conduct a referendum among dairy farmers to get their approval or disapproval of a proposed new or amended milk order. For new orders, the referendum method is always used. Cooperative associations are entitled to vote their "producer" membership as one unit. This is termed "bloc" voting.

When it is necessary to ascertain dairy farmers' views after an order has been issued, the referendum method is sometimes dispensed with if the necessary farmer approval can be clearly shown from the unit votes of organized producer cooperatives.

34. Can milk promotion, education and research programs be financed under Federal orders?

A 1971 amendment to the Agricultural Marketing Agreement Act of 1937 authorizes such programs on a market-by-market basis when approved by producers. A program is financed by deductions on all producer milk marketed under an order. The legislation requires that such funds be paid to an agency organized by milk producers and associations of producers and that a separate referendum be held on promotion provisions. Other provisions of an order are not affected if promotion provisions are disapproved by producers. Provisions may be made for suitable adjustments or credits on milk on which a mandatory checkoff for advertising or marketing research is made under a State law. Provisions shall be made for refund of producer deductions when requested by any producer.

When the National Dairy Promotion and Research Program, authorized by the Dairy and Tobacco Adjustment Act of 1983, became effective in 1984, Federal milk orders with advertising and promotion programs were amended to provide a fixed assessment rate of 10 cents per hundredweight. In addition, the orders were amended to provide that requests for refunds of the assessment be

honored by having the market administrator send such refunds to the National Dairy Promotion and Research Board or to a "qualified" regional, State or local dairy promotion, research or nutrition education program designated by the producer. Changes in the orders remain in effect for the duration of the national program.

35. What is the meaning of terms used in Federal orders?

a. Producer.

A producer is a dairy farmer who delivers "Grade A" or "bottling quality" milk to a regulated handler and therefore is entitled to the protection and benefits of a milk order.

b. Handler.

A handler is a milk dealer, processor or distributor who is subject to a Federal order because the handler distributes milk in a regulated marketing area or because the handler processes milk which may be disposed of or distributed in a regulated marketing area. Cooperative associations which market milk for their member producers also are handlers in many markets.

c. Minimum price.

A minimum price is the least amount that proprietary handlers can pay producers for milk. Only minimum prices may be set. Handlers may pay higher prices if they choose.

d. Marketing area.

A marketing area is a designated trading area within which the handling of milk is regulated by the Federal order. Generally, all milk dealers who handle or sell milk in the designated marketing area are subject to the regulation of the Federal order that applies in that area.

e. Marketwide or individual handler pools.

Because values for milk are based on classified uses, it is necessary to have a device for paying individual producers a uniform or average price for the milk they deliver to a milk handler. There are two types of pooling plans authorized for use in Federal order markets.

(1) Marketwide pool.

The minimum average price is calculated on a marketwide basis, combining into one total the utilization of all handlers and the total receipts from all producers in the market. By this arrangement, all producers receive the same uniform or blend price per hundredweight for the milk they deliver irrespective of the handler to whom it is delivered. Because of the different utilizations of handlers, it is necessary for the market administrator to maintain a producer-settlement fund for the purpose of equalizing payments among various handlers. Marketwide pooling is currently used in almost all Federal order markets.

(2) Individual handler pool.

A minimum average price is calculated on the basis of each handler's use and receipts of milk. Under this system, farmers selling to different handlers may have different minimum average prices. This method of pooling has declined in use over the years and is currently being used on a very limited basis.

f. Reserve milk supplies.

Reserve milk supplies are the quantities of milk which are not used in Class I but are necessary for a reliable supply of milk. This reserve includes the quantities of milk in excess of Class I use which result from normal day-to-day and seasonal variations in production and consumption of milk.

The term "surplus milk" is often applied to milk which is not used as Class I in the marketing area. This term, however, is frequently a misnomer because an adequate and dependable supply of milk for consumers requires that short-time and seasonal reserves be maintained. A surplus arises in a market when the quantity of milk delivered exceeds the quantity of milk sold in fluid form by an amount which is greater than the necessary reserve. And it can be considered "surplus" only when this condition continues for a period of time.

g. Seasonal incentive payment plans.

Two types of seasonal incentive plans are authorized for use in Federal milk orders to encourage more even production of milk throughout the year. They are the Louisville (takeout and payback) plan and the seasonal base plan for paying producers.

(1) Louisville plan.

A specified amount is withheld from the blend price or producer-settlement fund during the months of normally high production. In each of several fall months, when milk production is at its lowest level, a proportion of the total amount withheld is paid to producers.

(2) Seasonal base plan.

Every year, each producer establishes a base equal to the producer's average daily delivery of milk during the season of low production for the market. The base-forming period is specified in the order and need not be limited to one year. During the base-paying months, a producer is paid a higher price for the portion of the milk that does not exceed the producer's base and a lower price (approximately equal to the surplus class price) for deliveries that exceed the producer's base.

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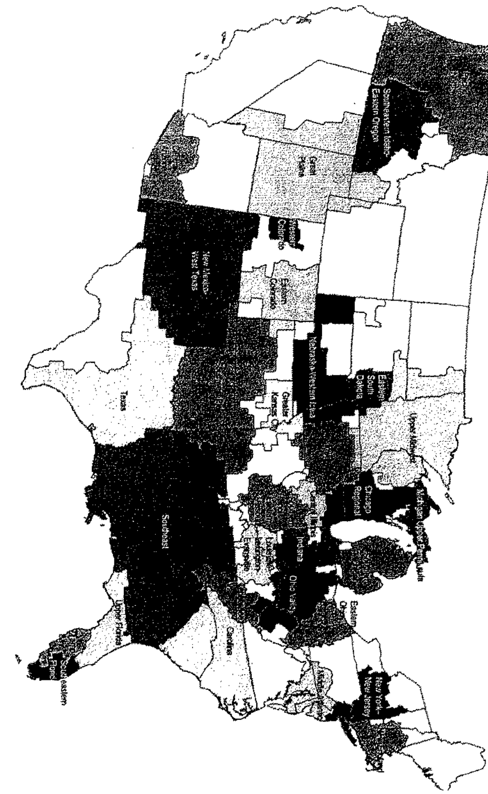
Federal Order Marketing Areas As Of October1, 1996



APPENDIX B — MEASURES OF GROWTH IN FEDERAL MILK ORDER MARKETS, 1950-95

Year	Markets [1]	Population [2]	Handlers [3]	Producers [3]	Producer deliveries	Class I use		Prices [4]		Receipts as share of milk marketings		Daily deliveries per producer	Gross value of milk [6]	
								Class I	Blend	Fluid grade [5]	All Milk		Per producer	All producers
	No.	Thou.	No.	No.	Mil. lb.	Mil. lb.	Pct.	Dol. per cwt.		Pct.	Pct.	Lbs.	Dol.	Mil. dol.
1950	39	*	1,101	156,584	18,660	11,000	58.9	4.51	3.93	41	25	326	4,914	769
1955	63	46,963	1,483	188,611	28,948	18,032	62.3	4.67	4.08	51	32	420	6,510	1,228
1960	80	88,818	2,259	189,816	44,812	28,758	64.2	4.88	4.47	64	43	648	10,482	1,990
1965	73	102,351	1,891	158,077	54,444	34,561	63.5	4.93	4.31	70	48	944	15,300	2,419
1970	62	125,721	1,588	143,411	65,104	40,063	61.5	6.74	5.95	79	59	1,244	27,636	3,963
1975	56	150,666	1,315	123,855	69,249	40,106	57.9	9.36	8.64	78	63	1,532	49,233	6,098
1976	50	157,295	1,305	122,675	74,586	40,985	54.9	10.70	9.75	79	65	1,661	60,277	7,394
1977	47	159,504	1,260	122,755	77,947	41,125	52.8	10.59	9.69	80	66	1,740	62,692	7,696
1978	47	161,224	1,189	119,326	78,091	41,143	52.7	11.40	10.57	80	67	1,793	70,528	8,416
1979	47	163,053	1,127	116,447	79,436	41,011	51.6	12.88	11.97	80	67	1,870	83,262	9,696
1980	47	164,908	1,091	117,490	83,998	41,034	48.9	13.77	12.86	80	67	1,954	93,685	11,007
1981	48	166,663	1,058	119,323	87,989	40,746	46.3	14.69	13.63	80	68	2,021	102,354	12,213
1982	49	172,775	1,010	120,743	91,611	40,807	44.5	14.63	13.53	81	69	2,079	104,573	12,627
1983	46	175,624	958	121,052	95,757	41,091	42.9	14.69	13.53	82	70	2,168	109,142	13,212
1984	45	177,524	912	119,033	91,676	41,517	45.3	14.41	13.33	81	70	2,104	104,935	12,491
1985	44	176,440	884	116,765	97,762	42,201	43.2	13.88	12.61	80	70	2,294	107,871	12,596
1986	44	177,992	849	112,322	98,791	42,725	43.2	13.60	12.38	80	71	2,413	111,581	12,515
1987	43	180,374	797	105,882	98,182	42,876	43.7	13.90	12.51	80	71	2,542	118,402	12,530
1988	42	184,180	776	104,141	100,066	43,141	43.1	13.42	12.14	79	71	2,627	119,261	12,420
1989	41	185,919	748	100,291	95,871	43,367	45.2	14.51	13.30	75	68	2,614	129,744	13,013
1990	42	195,841	753	100,397	102,396	43,783	42.8	15.55	13.78	77	70	2,796	142,324	14,290
1991	40	198,409	722	100,267	103,252	45,033	43.6	13.30	12.11	76	71	2,821	121,479	12,180
1992	40	200,530	698	97,803	107,947	44,914	41.6	14.57	13.12	77	73	3,017	146,452	14,324
1993	38	199,604	675	92,934	103,979	44,805	43.1	14.19	12.89	73	69	3,065	145,369	13,496
1994	38	201,487	651	92,052	107,818	44,866	41.6	14.75	13.16	74	70	3,209	154,140	14,189
1995	33	207,354	579	88,727	108,556	44,968	41.4	14.19	12.78	73	70	3,352	157,706	13,993

* Data not available.
1/ End of year. (Date on which pricing provisions became effective.)
2/ Population in Federal order markets at end of year. 1955, 1960-70, 1971, 1980, and 1990, according to 1950, 1960, 1970, 1980, and 1990 U.S. census, respectively. 1972-79, 1981-89, and 1991-95 are estimated.
3/ Average for year.
4/ Prices at 3.5% butterfat are simple averages for 1950-60 and weighted averages for 1965-95.
5/ The decrease in these percentages for 1988-95 results from handlers electing, because of unusual price relationships and qualification circumstances, not to pool milk that normally would have been pooled under Federal milk orders.
6/ Gross value at blend price adjusted for butterfat content.

Testimony for House Agricultural Subcommittee on Livestock, Dairy and Poultry Hearing on April 24, 2007

Good morning, my name is Kelly Krug. I am the Director of the Division of Marketing Services of the California Department of Food and Agriculture. Thank you for the invitation to speak to you about the hearing process used by California's dairy pricing and pooling systems.

I direct the Division of the Department that administers the State's milk pooling and pricing system. For more than 70 years the Department's California dairy pricing program has worked to carry out four goals established by the California legislature which are stated in the Food and Agricultural Code: They are: 1) maintain an adequate and continuous supply of pure and wholesome fluid milk to consumers; 2) eliminate unfair dairy trade practices; 3) promote and encourage intelligent production and orderly marketing; and 4) maintain a reasonable level of stability and prosperity in the California dairy industry. These goals address the interests of all parties, including producers, processors, cooperatives, retailers, and consumers. California's dairy pricing system is similar to federal milk marketing orders. Both rely on establishing minimum farm milk prices for producers.

USDA's federal milk marketing orders regulate more than two-thirds of the Grade A milk marketed today. California is the principal milk production area that does not fall under the jurisdiction of a federal order and has maintained its own state milk marketing order since the passage of the Young Act in 1935. California also has operated a milk pooling program since the passage and implementation of the Gonsalves Milk Pooling Act in 1968 which provides for dairy producers to share their revenue from the sales of all classes of milk. Again, California's operation of milk pooling is quite similar to pooling that is done in federal milk marketing orders.

Currently, California operates its milk pricing plan with two marketing areas: Northern California and Southern California. Each marketing area has a separate but essentially identical Stabilization and Marketing Plan. Each plan specifies the formulas for establishing minimum prices for California's five classes of milk. Much like federal milk marketing orders, and to promote stability in the State's dairy industry, California's milk marketing program establishes minimum prices that processors must pay for fluid grade or Grade A milk received from dairy farmers based on end product use. These prices are established within defined marketing areas where milk production and marketing practices are similar.

The California pricing system is designed to encourage innovation and react quickly to market signals. Minimum farm prices are determined by supply and demand signals that are based upon actual market prices for manufactured dairy products. These formulas are established through a public hearing process in which interested parties offere testimony and evidence relating to the proposed formulas. Revisions to these pricing formulas, other provisions of the Stabilization and Marketing Plans, and provisions of the Pooling Plan for Market Milk are made only after a public hearing has been held.

Most hearings are initiated by entities representing either milk producers, cooperatives, or milk processors but can be requested in writing by any interested party. Infrequently, the Department will call for a hearing on its own motion. This formal hearing process generally allows for changes to be implemented in approximately three to five months.

Next, I will outline the steps of the hearing system:

The request for a hearing must be received in writing and must specify which Plan is recommended for change, that is, which of the Stabilization Plans and/ or the Milk Pooling Plan. A request must explain why a change is sought and must included relevant analysis and data along with proposed implementation language.

Once a request is received, the Department has 15 days calendar days to decide if a hearing will be granted. If the Department accepts the request, a formal hearing announcement is released with a timetable for the hearing events.

A filing period for submission of alternative proposals is identified and a few weeks before the hearing is conducted, the Department will hold a prehearing workshop. The workshop allows the requestor and any parties filing alternatives to explain their proposals. The Department also performs initial analyses of all proposals which are released at the pre-hearing workshop.

Departmental exhibits are made available to the public seven days prior to the date of the hearing. Then the hearing is conducted. Most hearings require one or two days to complete. The Department generally allows up to a 10 day brief filing period for participants to clarify or amplify their testimony presented at the hearing.

From the date of the hearing completion (oral testimony), the Department is required by the Food and Agriculture Code to implement any changes resulting from the hearing within sixty-two days. The Code also requires a ten-day notice to the public of the upcoming changes which reduces the analysis time to 52 days from the hearing closure.

I have included a hearing timeline diagram with my testimony that further explains the hearing process. Also, a summary brochure is included that provides details of the dairy hearing process to interested parties.

This concludes my testimony. Thank you for the opportunity to speak today about the hearing process used for the California dairy pricing and pooling systems. If you have questions regarding our program, I'll be happy to try to answer them.

Attachments (2) Hearing Pamphlet, Hearing Timeline

How You Can Participate and What to Expect . . .

MILK PRICING HEARINGS

California Department of Food and Agriculture
1220 N Street
Sacramento, CA 95814
www.cdfa.ca.gov/dairy

The Hearing Process

Hearings on California's minimum farm prices are held to gather relevant testimony and evidence regarding whether or not the current pricing formulas are serving the purpose for which they were intended. This is to provide for an adequate and continuous supply of fresh wholesome milk to consumers at reasonable prices.

Call to Order and Introductions

The Hearing Officer facilitates the orderly administration of the hearing process. The Hearing Officer will call the hearing to order and explain the purpose for the hearing. The scope of the hearing may be broad, covering several pricing formulas or may be narrowly focused on a single pricing formula.

Next, the Hearing Officer will introduce the hearing panel. The panel is usually composed of 3-to-4 Department staff. Their purpose is to listen to testimony and ask clarifiying questions of each witness to ensure that the hearing record is as complete and clear as possible.

The Department Witness

The Hearing Officer will then ask the Department's witness to come forward, be sworn in under oath (as are all witnesses) and present the Department's exhibits. This will include a background analysis and an analysis of petitions and proposals submitted. Finally, the Department witness will introduce any related written correspondence submitted in advance of the hearing.

The Petitioner and Alternative Proposals

Next, the Hearing Officer will call the petitioner (if there is one) to present their testimony. One hour is allowed for the petitioner to present the merits of their petition. After questions from the panel, the Hearing Officer will then ask those that have submitted alternative proposals to present their testimony. Each person will be allowed thirty minutes to present the merits of their proposal.

The Hearing Witnesses

The Hearing Officer will begin to call witnesses in the order of their signing in on the witness register. Each person wishing to testify is allowed twenty minutes to present their testimony and evidence. All testimony must be relevant to the call of the hearing and must be directed at the Hearing Officer and panel. Each witness will be subject to questions from the panel. However, it is not the intent of the panel to debate, but merely to clarify testimony and evidence presented. For instance, if data is presented, the panel may ask for the source of that data.

The Post-Hearing Briefs

If there is time left after all witnesses have testified, the Hearing Officer will ask if anyone wishes to add any further testimony. Persons who are sworn in and testified at the hearing may request to submit a post-hearing brief for the purpose of amplifying, explaining, or withdrawing their testimony. If a post-hearing brief filing period is granted, the hearing record would be held open for that period of time, usually 5-to-10 days. Witnesses that do not request an opportunity to file a post-hearing brief will not be allowed to do so (Food and Agriculture Code Section 61903).

Questions & Answers Regarding Hearings

If I attend a hearing, do I have to testify?

No, all milk pricing hearings are open to the public and only those that sign up to testify will be asked to do so.

If I choose to participate, am I required to have written testimony?

No, while written copies (6) make it easier for the hearing panel to follow your testimony, it is not required.

I would like to voice my opinion regarding California's milk pricing system, but am uncomfortable testifying at a hearing. Is it possible to submit testimony by any other method?

Yes, you can submit your comments to the Secretary of Food and Agriculture in advance of the hearing and ask that your letter be introduced into the hearing record.

Because sworn testimony offered at a hearing is subject to questions from the hearing panel, more weight is given to that testimony. However, for those that are uncomfortable speaking at a hearing, or cannot travel to attend a hearing, all correspondence received prior to the hearing will be given consideration by the hearing panel in preparing its findings and recommendation to the Secretary.

If I choose to write a letter, where do I send it?

Mail the letter to the Secretary of Food and Agriculture, in care of the Dairy Marketing Branch, 1220 N Street, Sacramento, CA 95814, or send by fax to (916) 341-5988.

If I choose to attend a hearing, how long should I expect it to last?

The length of the hearing will, of course, depend on the scope and sensitivity of the call of the hearing. The Department makes every effort to complete the hearing in one day and will continue taking testimony into the evening if necessary. However, most hearings are completed by 5:00 p.m. on the first day.

The Hearing is Over, What's Next . . . ?

Once the hearing is over, the Department is allowed 62 days to announce its determinations. However, if the Department determines that amendments to the system are warranted, the determination must be announced at least 10 days before they are implemented.

Depending on the scope of the hearing, the Department may require the full 62 days to arrive at its determination. However, the determination is often announced ahead of the statutory deadline.

After the close of the hearing record, the hearing panel will begin its review of all testimony and evidence received. Deliberations will continue until a consensus is reached and a Panel Report is prepared. This report includes an economic analysis of the hearing record and is submitted to the Secretary to assist in making the final policy decision.

Once the Secretary's decision is reached, the formal Statement of Determination and Findings is prepared and announced.

Want more information on milk pricing?

Visit our website at:
www.cdfa.ca.gov/dairy

or call: **1-800-503-3490**

Information and Assistance

Department staff is ready to provide whatever information and assistance is needed to anyone wishing to participate in the hearing process. While staff cannot prepare testimony or discuss hearing issues, they can provide economic data and analyses.

For more information, please contact the following staff as needed:

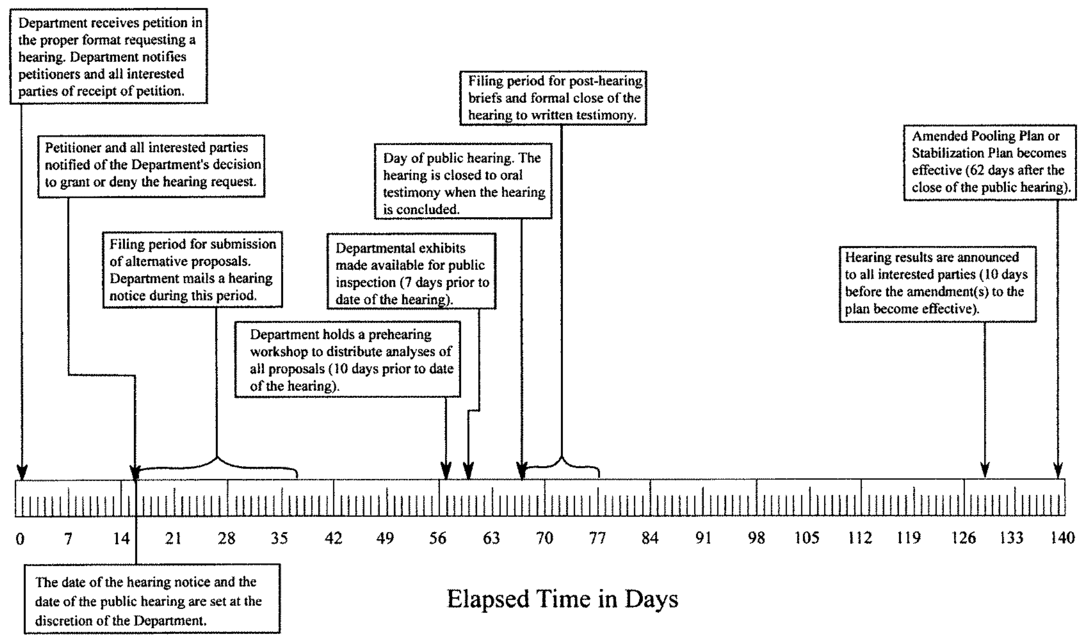
Economic data on the dairy industry:
Candace Gates
Cost of producing milk:
Mike Francesconi
Cost of manufacturing milk:
Venetta Reed
Dairy statistics:
Candace Gates or Karen Dapper
Milk Pooling:
John Lee or Don Shippelhoute

The staff above can be reached at:
Dairy Marketing Branch
1220 N Street
Sacramento, CA 95814
Phone: (916) 341-5988
Email: dairy@cdfa.ca.gov

Please note: If you require a special accommodation, please contact our office at (916) 341-5988 or TDD (800) 735-0193

Public Hearing Timeline

Public hearings are the avenue in which changes to the Milk Stabilization and Marketing Plans, pricing formulas, and provisions of the Pooling plan for Market Milk are made. Most hearings are initiated by representatives of milk producers, cooperatives, or milk processors, and require formal submission of a hearing petition. Occasionally, the Department will call a hearing on its own motion. When changes are suggested by an interested party – they file a petition for a public hearing with the Department. The Secretary reviews the petition and determines whether to grant or deny the request. As shown in the diagram, the Department must accept or deny a petition within 15 days of receipt.



Chris Kraft – Member / Owner Dairy Farmers of America, Inc.

Testimony Before the
U.S. House of Representatives Committee on Agriculture
Subcommittee on Livestock, Dairy and Poultry
Hearing on Federal Order Rulemaking Procedures
April 24, 2007

Good Morning. I am Chris Kraft. My wife Mary and I own and operate two dairy farms in the Fort Morgan, Colorado area. Our farms combined produce approximately 49 million pounds of milk per year or the equivalent of 2.5 tanker loads of milk per day. I am a Dairy Farmers of America (DFA) Mountain Area Council Board member. My cooperative markets my milk and the Colorado producers I represent in Federal Order 32 – the Central Order.

DFA is composed of more than 11,300 farms in 49 states. We pool milk on 10 of the 11 Federal Orders. We have participated in every Federal Order Hearing that has been held since DFA was formed in 1998. We work daily with every Market Administrator office, speak regularly with the Office of the Deputy Administrator on milk marketing concerns and have supported the Order system at Hearings, before Congress, in the media and in the courts.

The US dairy marketplace for is composed of approximately 62,000 commercial dairy farmers, 400 fluid-milk processing plants owned by perhaps as few as 75 entities. Ten retailer companies that, according to the industry publication Supermarket News, account for 68.4 percent of all grocery sales have a firm grip on the retail grocery market. Clearly dairy farmers are not in a position of equal bargaining power and Federal Orders are key in maintaining a more level playing field for dairy farmers. Orders provide the marketing framework for dairy farmers. They announce and enforce minimum prices, provide common terms of trade for milk marketing, insure

timely and accurate payment for milk sold by farmers and audit milk sales to help farmers capture their share of consumers' dollars. Without them producer incomes would be worse and we feel consumers would be ill served.

Orders are composed of complex and strictly defined provisions that are tightly worded and done so because regulatory policy simply cannot be as flexible as daily market transactions might otherwise demand. Because the dairy industry and markets evolve, Orders must be open to change. While the industry appreciates the fact that the change process should be open, transparent and deliberate, the extreme slowness of the process leads many to become disgruntled and discouraged leading to frequent complaints. Certainly each of you listening to me understands that constant complaints about any issue, even when unjustified, ultimately result in action; and sometimes the wrong action. I am concerned that if the Federal Order Hearing process is not improved producers will succumb to the constant rhetoric about the negatives of Orders and throw the baby out with the bathwater.

In my testimony today, I will outline three issues involving the Federal Order system and the Hearing process. They include, 1) changes needed to streamline the Order Hearing and Decision procedures and the data necessary to hold a Hearing, 2) the inadequacy of staffing levels at key positions within the Order system, 3) a few key comparisons between the Federal Order System and the California State Order system.

The industry is very concerned about the length of time that it takes to make changes in the provisions of a Federal Order. There are no mandated time constraints to institute a sense of urgency to the process. A Decision can sit on a reviewer's desk within the approval process with no urgency to be addressed because there is no deadline for doing so. Public perception has been that Decisions were delayed either for political reasons, or simply because the Decisions were viewed to be controversial. Our Cooperative has several business lines that are currently stymied in their planning and marketing operations because an Order Decision that affects them has not been announced in a reasonable time. We feel that USDA does a good job moving Decisions through the process so long as the Decision itself remains inside the Dairy Programs staff area. However, once they travel up

the chain-of-command and back down, with any revisions needing multiple briefings, reviews and rewrites the process often stalls. It would be helpful if USDA revised its Administrative Procedures rules (the legal code that defines the Hearing process) to institute guidelines and timetables. For example, if all Decisions were required to be published to the industry within a certain period of time – possibly 100 days after a Hearing – USDA would have to streamline the process. The Committee should get a clear answer from Mr. Day this morning whether or not USDA believes it can promptly effect this type of rule change in its own Administrative Procedures process on its own or whether it requires Congressional action. Either the Federal Order System should be exempted from certain of the review processes or given the authority to certify that a particular Decision meets the intended non-Dairy Division rules or requirements.

Mr. Gallagher outlines several examples of procedural changes specific to the Hearing process, including a formal review of the process by a third party that would report back to this Committee. We very much endorse this review concept and urge the Committee to adopt it. More specifically, we would be willing to participate in the process if asked. Our Cooperative has staff and resources that are devoted to working with the Order system and we feel we could have much to offer to the review process. Mr. Gallagher also outlined several step-by-step suggestions of how the Hearing process could be streamlined and we support the concepts as he defined them. A review of the timelines he established may need more discussion but the concept itself is in the right direction.

We would appreciate the Committee requesting a report from Mr. Day, within 60 days, as to how USDA intends to speed up the Hearing process and follow-up progress reports on how those steps are being completed. We realize that changing the Administrative Procedures practices itself is complex – for good reason, but we must start to make these changes if we are going to improve the process.

A second issue related to the Hearing process that needs attention, because the dairy industry by itself cannot do an adequate job, is in the area of collecting and providing data relative to the product price formula

hearings. Milk is a perishable product. As a dairy farmer I have to sell my product every day. I simply can't put milk in an elevator and wait to bargain for a better price tomorrow. Our industry requires a system that establishes prices in a reasonable time and is reflective of market conditions. Personally I'd like to set prices for the year on the day school opens – it is usually hot, the cows are not happy and don't produce a lot of milk; school demand is a significant boost to Orders and seasonally cheese demand is ramping up ahead of holiday orders – so milk is tight. Our processor customers would probably like to set prices on New Years Eve when demand is off, milk production is turning up and supplies long.

Our current system uses storable dairy products to set perishable milk prices. This mechanism is termed product price formula pricing. It is a reasonable way to price milk, but to do this the industry needs good price discovery, milk component and plant yield data and the cost to convert milk into various products. Everyone in the industry has a vested interest in the numbers that must be generated for the price formulas so each of our individual company data presented at Hearings is biased. We need USDA to do product yield research and cost surveys and publish the data for the industry to use.

The process of sorting through all the proprietary data at a Hearing is difficult at best. Each side has its own data set and reports as it chooses – but always with and eye on their own interests. The current hearing record on product price formulas will be more cumbersome than the tax code and the industry media will be so full of unreasonable statements that many of the participants will judge the quality of the Final Decision by observing if there is a near equal number of complaints from both sides of the issue rather than the reliability of the process itself! USDA needs both funding and directives to establish the type of data I referred to above. This will speed the Hearing process and provide all parties with base data to operate from at price formula hearings. Providing market information is a legitimate function of government.

With respect to staffing, it is important to remember how extremely complicated the Federal Order system is, and how dairy products are priced in the United States. That said it is critical that knowledgeable staff are appropriately placed and that the system is designed to maintain that necessary knowledge base.

The Dairy Programs Division has organized its staff to place individuals who review industry requests for provision changes, actually hold Hearings and write Decisions in a work-group known as the Order Formulation staff. The knowledge base for these positions is extremely specialized and takes some time to develop. The Dairy Programs Division rightly separates the Order Formulation staff, housed here in Washington, from the day-to-day Order Administration process. This is proper – but the Order Formulation group is simply understaffed. Currently there are only two senior level staff members – an inadequate number to support the needs of the industry. We believe that it has become increasingly difficult to attract and retain younger staff for these important positions. As they gain knowledge and experience, they have opportunities to parlay their experience to other sectors of the industry and move to locations where their income, cost of living and personal lifestyles may be preferable to the Washington D.C. area. I am sure each one of you faces this type of decisions with your own staff make-up. Indeed it seems that most Congressional offices are composed of younger professionals who simply cannot remain in their position for too long due to economic considerations.

If we are going to have a responsive Order system there must be more resources to administer changes to it. It is extremely difficult to attract the needed knowledge base to Washington because of the relationship of cost of living, quality of life and pay grades. So either the pay grade must be raised, the resource personnel officed outside the Washington DC area – or the system will grind to a halt.

Finally, I'd like to comment on some of the shortcomings and the strengths of the California system compared to the Federal Order system. The California system requires that decisions be announced in 62 days from the end of a Hearing. Federal Orders should strive toward this type of schedule. However, the California

system is aided by several factors that are simply not available in a Federal Order. As required by the California State Milk Marketing Order all milk produced in California is eligible to be included by the Order regulation – there is no debate about who shares in the Order proceeds or how one meets the requirements to share. This is not true in Federal Orders. Claiming a portion of Order proceeds is earned by the extent to which one supplies the fluid market. This fact causes much of the contention in Federal Orders and we are not proposing fewer or single Orders – rather just noting the facts. It is only human nature to want to share more but supply less – this makes Federal Order Hearings more contentious and will not be solvable as long as we have more than one market for fluid milk. Because markets have different combinations of milk production, demand, supply and consumption trends there will be more than one fluid milk market and more than a single Federal Order in the US for some time into the future. Additionally the rules of procedure in California, in our opinion, overly limit discussion and information exchange that can take place at a Hearing so while Federal Orders need to move in that direction, just copying the California process is not the correct decision.

Finally, the CDFA system does an unparalleled job of collecting industry data that is needed for a Hearing on price formulas. For example, California collects data on milk volume, component test, product yield, by-product yield and plant-processing costs and regularly publishes this data for industry review. The Federal Order system must begin to collect this type of information if it is to regain industry support for the Hearing process.

Thanks for listening to my thoughts – producers need your interest. If you have any questions I will try to answer them and those I can't answer here I will get a written reply from our staff. We have a good and vital tool in the Federal Order system. But of we are not careful, inattention will result in producers getting so disillusioned that they will make poor decisions about the usefulness of Orders.

MIDWEST DAIRY COALITION

Testimony of Dennis Donohue
General Manager, Manitowoc Milk Producers Cooperative

On behalf of the

Midwest Dairy Coalition

before the

Subcommittee on Livestock, Dairy and Poultry
Committee on Agriculture
U.S. House of Representatives

for a hearing on

"Review of Federal Milk Marketing Order Rulemaking Procedures"

April 24, 2007

Chairman Boswell, Ranking Member Hayes, Members of the Subcommittee-

Thank you for the opportunity to testify today regarding federal milk marketing order rulemaking procedures.

I am Dennis Donohue, General Manager of Manitowoc Milk Producer Cooperative based in Manitowoc, Wisconsin. Manitowoc Milk Producers is a Capper-Volstead Cooperative representing 2,900 dairy producers who ship their milk to proprietary dairy plants. These producers produce over 4 billion pounds of milk. We are a bargaining cooperative representing our producers under the federal milk marketing order system.

I offer this testimony today on behalf of my cooperative as well as the Midwest Dairy Coalition, of which Manitowoc is a longstanding and active member.

The federal milk marketing order system has been in existence since it was created by the Agricultural Marketing Act of 1937. The number of federal orders has ranged from a high of 83 in the mid-1960s to the current low of 10 orders. While some of the reduction in the number of orders has been a result of orders being voted out by the farmers and cooperatives in the affected area, most of the reduction has been a result of consolidation and mergers between orders. Even though the number of orders have been consolidated and streamlined, the rulemaking procedures for making changes are more time-consuming, convoluted, and costly than ever.

It is no secret that federal milk marketing orders are controversial in the Upper Midwest. Many producers and cooperatives in our part of the country believe that the structure of the federal orders is biased in favor of high Class I utilization regions and against regions, such as ours, where the majority of the milk is used in manufacturing. Some producers and producer groups argue that the federal orders should be eliminated all together. My cooperative does not support the elimination of federal orders, because we see them as beneficial to our producers. However, we share many of the concerns about the need for a more equitable structure for the federal orders.

Without a doubt, some of the frustration in the Upper Midwest regarding the federal orders is related to cumbersome and uncertain procedures for making changes to federal orders.

First, there appear to be no clear and consistent criteria for USDA to use in determining whether or not a hearing request will be granted. Some proposals that seem to have little merit are given full hearings, seemingly for political reasons, even though they may be in conflict with some of the basic principles of the Agricultural Marketing Act of 1937. This wastes time and money, both for taxpayers and for farmers, cooperatives and processors.

Second, there are no clear and consistent criteria for how long it will take USDA to respond to a request for a federal order hearing. For example, in September of 2005 a

significant portion of the dairy industry requested an emergency hearing to adjust make allowances for manufactured dairy products. A hearing was not held on this issue until January 24, 2006, about 4 months after the initial request. In contrast, in the case of the recent request by National Milk Producers Federation for an emergency hearing to amend Class I and II price formulas, the request was made on October 2, 2006 and the hearing was held on December 11 of 2006, roughly 2 months later.

Third, the timeline for how long a hearing will be held after it has been formally announced is often too short. The process of preparing for a federal order hearing is very involved and complicated. The affected parties should be given adequate and consistent time to prepare.

Once a hearing starts, the process is much too time consuming and costly. It is not uncommon for federal order hearings to last a week or more, and for single witnesses to be on the stand presenting their statements and being cross examined for three hours or more at a time. As a result, the price tag for legal and technical representation often runs into the tens of thousands of dollars for a single hearing subject.

After a hearing is completed, the delays before a decision is made are excessively long. In the case of the Class III and IV make allowance changes, the tentative final decision was issued on November 22, 2006, roughly 10 months after the hearing began on the subject. And this was designated an "emergency hearing."

Once a final decision has been announced, producers and cooperatives are often given an inadequate amount of time to vote on the referendum on this subject. Often, when a cooperative such as mine is involved, we must discuss the subject at a board meeting before we make a decision on the referendum. Yet in some cases, the referendum deadline is so soon after the announced decision, there is no time for the board to meet on the subject.

Many have pointed out that the procedures used in California's state order are much more streamlined and standardized, and have suggested that the federal order process should be modified to follow California's model. In general, I agree. However, because of the multiple orders and regions involved with the federal system, the inter-regional analysis that USDA must conduct on each proposed order change may require <u>slightly</u> more time for decisions, relative to the California system.

In light of these concerns, the federal milk marketing order rulemaking procedures should be modified to:

1) <u>Establish clear and objective criteria for determining whether or not a hearing request will be granted.</u>

A burden of proof should lay with the party or parties requesting a hearing to show that the proposal is consistent with the requirements of the Agricultural Marketing Act of 1937, and that there is significant support for the proposal. In the absence of those criteria being demonstrated, USDA should not grant a

hearing. In this manner, political pressure for USDA to move forward with a narrowly supported proposal that is inconsistent with the AMA of 1937 can be more readily denied, sparing a great deal of unnecessary time, expense and market uncertainty.

2) Establish clear timeline for how long USDA has to respond to a hearing request.

If clear criteria are established to govern USDA decision making about whether or not to grant a hearing request, it should pave the way for a more timely decision. USDA should be given a maximum of 2 or 3 weeks to grant or decline the hearing request.

3) Establish clear timeline for how much time needs to elapse between the hearing announcement and the hearing date, to give the affected parties adequate time to prepare for the hearing.

Once a hearing is announced, the hearing should be held 45-50 days later, to give adequate time for the affected parties to prepare.

4) Establish clear procedures and time limits on presentations and cross-examination during the hearing process.

5) Establish time limits for how long USDA will have to make issue a decision after the completion of federal order hearing.

There should have no longer than 3 months for USDA to issue a decision after a hearing is completed. It may be possible to establish a shorter time limit for single-order decisions, relative to national hearings.

6) Establish timelines for how long the affected parties will have to review a decision prior to the referendum deadline.

Once a decision is announced, affected parties should have 45 days before the vote on the referendum. This will assure that most producer-owned cooperatives will be able to meet with their boards prior to the vote.

Each of us affected by federal orders have been on both sides of federal order proposals. For those proposals we oppose, there is a tendency to want the decision to be put off indefinitely. For those that we support, we always want a quick decision in our favor. But by establishing clear and objective procedures for federal milk marketing order rulemaking, we all gain. It takes the guesswork out of the process, minimizes costs, and assures that no one group has an unfair advantage.

In Closing

The federal order rulemaking procedures are one small part of the overall issues related to the federal milk marketing order system, and even smaller still relative to the many dairy policy issues confronting this Committee as you prepare to mark up the 2007 Farm Bill. Therefore, it is important to reiterate that our main dairy policy priority for the Farm Bill is to maintain and strengthen a credible safety net for dairy producers, as reflected by a

continuation of the Milk Income Loss Contract (MILC) program and a reauthorization of the milk price support program, with adequate changes to make it a true safety net.

Thank you for this opportunity to testify.

U.S. House of Representatives – Committee on Agriculture
Livestock, Dairy and Poultry Subcommittee
Hearing on Federal Milk Market Orders
April 24, 2007

Testimony of:
Billy French
Dairy Producer
Maurertown, Virginia
On behalf of:
Virginia State Dairymen's Association

Good morning Chairman Boswell, Ranking Member Hayes, Members of the Subcommittee and my Congressman, Bob Goodlatte. I want to thank you for the opportunity to appear here today on behalf of the Virginia State Dairymen's Association, my cooperative, Maryland & Virginia Milk Producers and the South East Dairy Farmers Association.

I am here today as part of what I believe is a consensus in the U.S. dairy industry today that regulated milk marketing is beneficial for farmers, processors and consumers. While we have a regulated system, it is a system that is designed to respond to signals sent by the marketplace. When those market conditions change, the regulations are supposed to change with them. We may be living in the age of instant messaging, you know overnight mail isn't even fast enough anymore, but our milk marketing regulations have not been able to keep up to date fast enough for several years now. So I am also here to join the consensus opinion in the industry that our rulemaking process needs an update.

Like dairy farmers everywhere, we are struggling in the southeastern United States. After nearly two years of rock-bottom milk prices, we now have above-average farm milk prices. Our market-based system is indeed responding. Projections for the next several months look relatively strong.

Our input costs, however, are at record prices. Fuel prices have been high for more than two years. Just a little less than a year ago the price of feed grains began a rapid climb. Only the announcement of record corn planting intentions along with predictions of a "normal" weather year in the corn belt have started to soften feed grain prices in just the past couple weeks. Like dairy farmers everywhere, I am concerned that our input cost to milk price ratio will remain challenging, at best, for the foreseeable future.

Unlike dairy farmers everywhere, though, we in the southeast face these production challenges in the face of a fluid milk market that gets bigger every day. Population growth in the region far exceeds trends in other parts of the country. Federal Milk Marketing Orders 5, 6 and 7 are home to five metropolitan areas that experienced population growth exceeding 20% from 2000 to 2006. There are only a total of 16 cities that grew that fast during that time period in the entire country. The city of Atlanta, in the heart of the southeast, is the fastest growing big city in the country.

That population growth not only fuels demand, it also challenges supply because it drives up prices for agricultural land. According to USDA's National Agricultural Statistics Service (NASS) the southeast had the highest increase in cropland value in 2005, up $890 per acre in just one year to an average price of $4,550 per acre. The

increase was even more dramatic in Virginia with an increase of 21% in just one year to an average price of $4,900 per acre. State statistics show a similar increase for 2006.

To recap, we have the same challenges of input costs as dairy farmers everywhere else. But we operate in a region with a constantly growing population and where affordable farmland is increasingly difficult to come by. I believe our need for a milk marketing regulatory system that responds to changing market conditions might be even more immediate than the need elsewhere in the country.

The industry in the southeast has been affected in the past few years by those higher input costs much more than any other region of the country. We have asked for, and received, a hearing on increasing transportation credits to help cover the cost of moving an increasing amount of milk into the region during more weeks of the year to satisfy our market. The inter-market credits have been increased but our request for intra-market credits, which would help cover the cost of moving milk within our market, has yet to be acted upon.

The federal make allowance hearing, while addressing Class III and IV prices only, has reduced producer income in the region when the price signal sent to farmers should have been just the opposite. At the same time, federal order Class I differentials in use today reflect economic conditions of a decade ago.

And then there is the weather. You may have heard we've had a few Hurricanes in the southeast in the past few years. Extreme weather challenges every part of the country occasionally, but here again, the southeast is different. Even before the tragic events of Hurricanes Katrina and Rita in 2005, there were Charley, Frances, Ivan and Jeanne a year earlier. In 2004 the industry in the southeast sent a request for an

emergency hearing to seek assistance in covering the extraordinary cost of transporting milk during and after the four Hurricanes hit that year. Production was lost and had to be replaced – most often with milk transported from great distances and at great cost. When plants were shut down, the milk normally supplied to them had to be processed elsewhere – again with additional transportation costs incurred.

We asked for a simple, temporary, three-month increase in the Class I price in Federal orders 5, 6 and 7. Processors joined with us in the request. There was no opposition to the request or to treating the request as an emergency. Our request was made early that fall once the damage had been fully assessed. But it was months before we had a decision. In the meantime, farmers in the entire region bore the additional milk marketing costs associated with four Hurricanes in a row.

With all this being said, however, the USDA AMS staff is operating within the current requirements of the system. Federal order rulemaking must follow a set protocol. Interested parties are allowed to have their say.

Now that I am here having my say, I would like express my appreciation for Department staff that have shown a willingness to try to tackle some of our most difficult issues. Personnel at AMS have been willing to listen, offer suggestions and perhaps even a nudge to the industry in our area to help us get our act together on some potential solutions. For that I say thank you.

I would also like to thank my Congressman, Bob Goodlatte, for his efforts over the past several months to bring the industry together to look for solutions for the future. I have been to more than one meeting coordinated by the Congressman and his staff and I

can tell you that consensus within our industry on potential solutions would not be where it is today without him.

A cold, hard fact, however, is that people involved in any aspect of any issue come and go while it is the policies that remain. We need Federal Milk Marketing Order rulemaking that gets us decisions in 60 – 90 days, not the months or even longer that it takes to get decisions now. Let's construct a system that can make changes before crisis sets in. Let's build a system that allows us to be able to fix things before we get to the point where farm lenders and others who provide services, equipment and supplies to dairy farmers start calling their elected Representatives to ask them to do something about the fact that their customers can't pay their bills.

Again, thank you Mr. Chairman, other Members of the Committee and my colleagues in the industry for the chance to be here today. I look forward to working with all of you to help create a more timely rulemaking process for our milk marketing regulatory system.

Testimony of Eric Ooms
Before the House Agriculture Subcommittee on Livestock, Dairy and Poultry
Longworth House Office Building, Room 1300
Washington, D.C. 20515
April 24, 2007

My name is Eric Ooms. My father, two brothers and I own and operate a 400-cow dairy farm in Chatham, New York. We also grow approximately 1800 acres of corn, alfalfa and grass for our own herd and sell some to neighboring farms as well. Our family has been in the dairy business in our area since 1952, when my father and his family emigrated here from the Netherlands.

I serve on the New York Farm Bureau Board of Directors and also as the Chairman of the New York Farm Bureau Dairy Committee. Our farm has been a member of Agrimark and it's predecessor cooperatives since we installed a bulk tank in 1956. Our cooperative owns Cabot and McCadam cheeses.

As a dairy farmer, I would be remiss if I did not emphasize the importance of the MILC program and how important it is to have it extended in the Farm Bill and returned to the 45% rate that it started at in 2001. I realize that it not the charge of this hearing, but I had to mention it.

With the recent negative price/cost paradigm that the dairy industry has endured, many farmers are calling for closer scrutiny or elimination of the Federal Orders. While I do not have any objection to reviewing the Orders to assess whether the current patchwork structure with so many unregulated and state regulated areas is practical, to eliminate them at this point may be shortsighted. It is important to remember that the Orders exist in large part to facilitate the movement of milk within a region, not necessarily ensure a fair price to my farm or any other farm for that matter.

The first thing that comes to mind is the urgent need to amend the Federal Order system in such a way that it will be more responsive to changes in the market place. With the recent high energy prices there were several calls for USDA to review and adjust the make allowance for cheese.

Several cooperatives asked for an emergency hearing on this issue as early as March 2005. It took until November 2005 to agree to hold the hearing, which was held in January 2006. Based on the testimony presented in January, the department decided to have a follow-up emergency hearing in September 2006, by November 2006 a decision was reached and despite an unsuccessful lawsuit, the new rule was implemented in February 2007. That is two years to commence and act on emergency hearing! I can only guess that if there were a call for a hearing that was not seen as an emergency, the department would still be gathering the facts about what the Wright brothers have been

up to in Kitty Hawk, North Carolina. Regardless of what one thinks about the need for the changes that were made, this process should be able to be completed 6 months or less.

While this was going on, California, which has a state order, dealt with the exact same issue and the process took less than five months (someone mentioned to me, that they thought that it would have been done in less than four months, but they delayed in hopes that the Federal Order process would be done quicker). As a producer, it would be easy to think, why can't we in the Northeast simply opt out of the Federal Order and do it that way, but when you realize the number of states that we are dealing with in our milk shed, it is not quite that simple.

It would also be a good idea to include the ability for the Federal Orders to have the authority to add in a fuel price adjustment mechanism that can be paid by handlers. As it currently stands, when our haulers need more money to haul milk (and no one can doubt that these costs are legitimate) it always falls on the back of the farmers, there has to be a practical way to push this cost to a place where it is not 100% on the backs of farmers.

With the recent low milk prices, there has been a great deal of concern about whether our cooperative system is working for us. Let me state clearly, I feel that the answer to dairy farmers' problems can be cooperatives, so I would implore all of you to retain or strengthen Capper-Volstead. This does not mean that there does not ever need to be oversight of cooperatives or that being certain that cooperatives are doing an adequate job of educating their members as to what is happening within an industry. One tool to keep informed, in addition to what I receive from my cooperative is the monthly newsletter that Federal Milk Market Administrator sends each farm (this can be found online at www.fmmone.com).

One other area of concern is the lack of oversight and auditing over price reporting through the NASS survey. It is a more than a little disturbing that my family's income is based on a survey that essentially uses the honor system. Whether there is fraud or not, whether it is malicious or not, USDA needs to audit the reports just to be certain that they are correct.

Lastly, part of the reason why we need to streamline the process is the petition that is currently before the Department asking that would increase the price of milk for Class I and Class II. With the price of a gallon of milk in Brooklyn tied directly to the price a 40-pound block of cheese in Chicago, there certainly is merit to have a hearing an deal with the issue. The length of time that this hearing will take is an effective barrier from any regular farmer from following or participating in the process because few of us have three years to follow a hearing process.

I thank you for the opportunity to speak here today and would be happy to answer any questions or discuss these issues further.

Testimony of
Edward W. Gallagher
Vice President, Economics and Risk Management
Dairylea Cooperative Inc.

Before the
U.S. House of Representatives Committee on Agriculture
Subcommittee on Livestock, Dairy and Poultry
Hearing on Federal Order Rulemaking Procedures
April 24, 2007

Thank you for inviting Dairylea Cooperative Inc. to testify before you today. Dairylea is a dairy cooperative that markets milk on behalf of 2,400 dairy farmer members located in the Northeastern United States. Dairylea is the fifth largest U.S. dairy cooperative.

Dairylea supports the continuation of the Federal Order program, but recognizes that reform of the hearing process is necessary. Dairylea is tremendously appreciative that this Committee has taken the time to hold this inquiry on the Federal Order hearing process.

My name is Edward Gallagher. I live in Cazenovia, New York. I serve as Dairylea's Vice President of Economics and Risk Management. I have spent my entire lifetime working in the dairy industry. I was raised on my family's dairy farm in the small town of Sangerfield in Central New York State. The farm is now operated by my brother and his family. I have a Bachelor's degree from Cornell University and a Master's degree from The Ohio State University – both in Agricultural Economics. Upon graduation from Cornell, I became a full-time USDA employee at the former New York-New Jersey Market Administrator's office – as an economist. I worked for the Market Administrator's office for 12 years – the last 5 as its Chief of Market Analysis, Research and Information. In 1996, I was hired by Dairylea Cooperative. I have significant experience in both Federal and State Order hearing processes. I am a member of a number of work groups looking into Federal Order reform – including a National Milk Producers Federation task force. I believe I have much to contribute about the Federal Order hearing process.

The Federal Milk Marketing Order program has served the United States dairy farmer and dairy industry well over the last 70-plus years. It has helped to stabilize a factious market for Class I milk and to create equity among handlers and producers. It is our belief that it has been one of the most important economic development programs for the United States dairy industry. It remains important. Federal Orders assist in deriving Class I revenue in addition to what would otherwise occur; and the monthly minimum price announcements provide an important safety net and reference point from which most milk prices emanate. Dairylea strongly supports the continuation of the Federal Milk Marketing Order program.

Over time, Federal Orders will need to change to survive. The Orders must adapt to changing markets, marketing conditions, business practices and technological advancements,

among other things. Going forward, Federal Orders must be more market oriented and develop industry accepted pricing customs that can stand the test of time, if indeed, events should transpire resulting in the termination of the Federal Order program.

Federal Orders must be able to quickly adjust their regulations as circumstances arise, if the program is going to remain relevant. Presently, the process of changing Federal Orders to adapt to these changes takes far too long. Reform of this process is necessary. As part of this reform, the Secretary of Agriculture must have a mechanism that allows him or her to quickly address issues that are causing disruption in the marketplace. For instance, incentives to increase ethanol production are leading to strong increases in livestock feed prices without a commensurate response in the milk price. This has compounded a dairy farm profitability issue emanating from higher input prices because of energy related items such as diesel fuel, utility costs, fertilizer and chemicals, as well as general cost increases for labor, insurance, equipment and almost every other input. The Secretary of Agriculture must have the tools at hand to react quickly. It would help, for instance, if a decision to raise Class I prices could be immediately implemented. As it is, a hearing about increasing Class I prices ended four months ago and the industry has no idea when the decision might be issued.

The present operation of the Federal Order hearing process has resulted in hearings with no resolution or hearings where the ultimate resolution takes years. The failure to provide quick decisions has implications on the underlying support for the Federal Order program and generates business risk for dairy farmers, plant operators and businesses that market dairy products. For example, a hearing convened on June 20, 2005 to consider changes to what products will be included in Class I or not in Class I. The lack of resolution to this issue has resulted in some plant operators and marketers "shelving" new product innovation due to the uncertainty of the product's Federal Order cost basis. No one wins when this happens. Reform is needed to more quickly develop solutions.

Dairylea believes that the formal rule making process, utilized by USDA to change Federal Orders, should continue. However, it should be improved upon to result in faster hearing decisions. To accommodate this, the industry and USDA has to work together differently than in the past. Dairylea requests that the following 8 steps be taken to reform the process.

1) Authority to Increase Milk Prices

The Secretary of Agriculture should be provided with specific authority to temporarily increase milk prices within 30 days of a hearing considering an increase, provided such adjustment is appropriate. This would give the Secretary the ability to address the dairy farmer profitability crisis occurring as a result of higher livestock feed prices.

2) Completion of Open Amendatory Actions

Two "National" Federal Order hearings have concluded without a final decision being implemented or the proceedings terminated. This Committee should urge USDA to move to a final order and implementation within the next 45 days.

3) Support of USDA Actions to Facilitate Faster Hearings

USDA has taken a number of initiatives to hasten the hearing process. This includes outreach to industry to develop solutions to issues and pre-hearing conferences to discuss hearing proposals. These actions should be acknowledged, encouraged and, in some cases, codified.

4) Independent Report of Steps to Omit in Post-Hearing Decision Process

An independent review by a non-governmental accounting or consulting business should occur to identify whether steps may be omitted in the post-hearing approval process. Presently, a number of Federal departments must review and "sign-off" on Federal Order decisions. This adds to the delay in the process. A steering committee, to work with the business conducting the independent review, should be established, in order to facilitate a fast and timely report. The steering committee should be composed of no more than five people and include a person from this Congressional Committee, Dana Coale, Deputy Administrator of USDA Dairy Programs, a Market Administrator, a producer representative and a processor representative. A report should be forwarded to this Committee within 60 days of securing the independent review team.

5) Require Statutory Changes to Hearing/Amendatory Process

The Code of Federal Regulations should be amended to facilitate a different and faster hearing process. Deadlines for the steps of the process must be included. As part of this process reform, there must be greater interaction between those seeking changes and USDA – prior to requesting a hearing. Industry-wide pre-hearing conferences and the advance submission of hearing testimony must be required. These aspects will create better hearing records and reduce the length of time that USDA needs in the process of determining changes, after the hearing occurs, and in writing the decisions. Exhibits 1 and 1-a (attached), outline Dairylea's proposal to change the Federal Order rulemaking process. Dairylea presents this proposal as a part of the debate to reform the rule making process to generate faster decisions. With greater cooperation by the industry and the inclusion of tight deadlines, Dairylea believes that Federal Order changes can be implemented within seven to eleven months of a formal meeting with USDA describing the sought after proposal and within three to seven months of the beginning of a hearing. Certainly, the complexity of the issues at the hearing will impact the time frame.

The States of California, New York and Maine and the Commonwealth of Pennsylvania operate state milk marketing orders. These state orders have fast turnaround time from the date that a hearing is requested to the date that a change is implemented. The Committee should seek input into the various procedures used by these states in their efforts to produce timely decisions.

6) Hire/Retain Additional Administrative Law Judges

Administrative Law Judges (ALJ) are an important element of the hearing process. From time-to-time, USDA has had difficulty securing an ALJ for a hearing or there are scheduling conflicts that delay the hearing process. The identification or availability of an ALJ should not be a factor in the timeliness of the Federal Order hearing process. Additional ALJs should be hired or retained by USDA. To support the quick and efficient development of a hearing record, professional court reporting services should always be used.

7) Increase the Use of Market Administrator Staff Members

USDA has been making strides to increase its Washington, DC professional staff. It is important to have a strong and seasoned professional staff that can understand the complex

issues involved in milk marketing and Federal Order regulation. With the ever-increasing work load and the ever-increasing cost-of-living in the greater Washington, DC area, recruiting will continue to be a difficult challenge. Recently, USDA has reached out to professional staff members at the various Market Admininistrator's offices, to assist them in their hearing process. This should continue, be encouraged, codified if necessary and relied upon more often. The Market Administrator offices should be used to a greater extent to accomplish the economic analysis, policy decision making and decision write-up, that goes into the Federal Order hearing process. Additionally, the Market Admininistrator's offices tend to be in locations offering a more flexible cost-of-living. These offices should be looked to in an effort to attract and retain the professional staffing necessary to quickly accomplish the workload involved in the Federal Order hearing process.

8) Require the Secretary of Agriculture to Make Annual Reports on the Hearing/Amendatory Process

Within six months from today, the Secretary of Agriculture should appear before this Committee to report on changes USDA has made to the hearing process, to review all "open" hearings, to report on the length of time the hearings have been open, the types of hearing requests that have been turned down and other issues pertinent to the Federal Order program. Thereafter, the Secretary should report to this Committee on an annual basis. From this review, the Committee should publish a type of "report card" identifying how the Secretary is doing in handling issues relative to changing Federal Orders via the hearing process. To assist the Committee in reviewing the Secretary's accomplishments, a private industry group may be appointed by the Committee. Such appointed group should consist of no more than five people.

Thank you for providing the opportunity for me to testify today on behalf of Dairylea Cooperative. We look forward to working with you to strengthen the Federal Order program.

Exhibit 1

Dairylea Cooperative's Proposal to Reform Federal Order Rule Making Procedures

Testimony Before the U.S. House of Representatives Committee on Agriculture Subcommittee on Livestock, Dairy and Poultry Hearing on Federal Order Rulemaking Procedures April 24, 2007

- The process of Federal Order rulemaking must change so that USDA has the ability to understand the proposed changes, develop appropriate analysis, if possible, and have a road map of how it thinks it will change a Federal Order(s) – all prior to the hearing convening.
  - All referenced dates moved to next business day if such date falls on a weekend or holiday.
  - USDA is encouraged to manage the process so a rule making proceeding is not extended to each of the deadline dates
- USDA proactively works with dairy industry relative to possible changes to Federal Orders
  - USDA may announce its interest in holding a hearing on a particular change
    - The subject matter may be a result of a concept or idea raised by an interested party
  - USDA may hold a public meeting to discuss the issue in an attempt to prepare the industry to develop proposals
    - USDA may continue to hold private meetings with interested parties relative to changes to Federal Orders
- A proposed hearing petitioner must meet with USDA to discuss its proposal at least 10 days prior to requesting a hearing.
- Hearing request results in an agreement to 1) a hearing and announcement of a pre-hearing conference or 2) a rejection of the hearing request
  - Such notice as to 1) or 2) above must be made within 15 days of receipt of request to hold a hearing
  - At the time of the hearing announcement, USDA will also ask for additional proposals to be filed within 15 days
    - USDA may broadly or narrowly define the scope of the potential hearing
    - USDA may accept additional proposals at its discretion even if petitioner did not meet with USDA to discuss such proposal

      However, USDA must still be able to meet its deadlines
  - Such pre-hearing conference must occur within 20 days of announcement of acceptance of a proposal for a hearing and the announcement of the pre-hearing conference

- The purpose of the pre-hearing conference will be to allow the proponents to describe their proposals and answer questions about the proposals.
  - USDA will have unlimited time to ask questions.
  - Interested parties will be able to submit questions for proponents to USDA.

- Within 4 business days of the pre-hearing conference, any entity requesting a proposal to be heard, which will not be heard by USDA, shall receive written notification as to why such proposal will not be heard at this hearing.
- Within 5 business days of the pre-hearing conference, USDA will announce the hearing date and the proposals to be considered. Such hearing will occur no later than the first Monday that is 75 days after the pre-hearing conference.
- Within 1 day of the pre-hearing conference, proponents, opponents and interested parties will submit pertinent data requests to USDA.
  - Within 30 days of the pre-hearing conference, USDA shall supply such data or indicate why it can not be supplied.
    - All such data shall be put on the USDA website by the same date.
- Within 45 days of the pre-hearing conference, all proponents wishing to be heard at the hearing shall pre-submit their testimony. Within 15 days of proponent submission, opponents must pre-submit their testimony.
  - Pre-submission of hearing testimony provides USDA with an additional 15-30 days, prior to convening the hearing, to consider and analyze any potential changes to Federal Orders
  - Farmers do not need to pre-submit their testimony.
- At the hearing, pre-submitted testimony is entered into the record without being read. Individuals testifying are then cross-examined.
  - In such case, the proponent shall be allowed to make edits/corrections to the testimony and provide a five minute overview of the testimony.
  - USDA may make "hardship" allowances for entities unable to pre-submit their testimony, at the discretion of the ALJ.
- Industry briefs are due as prescribed by the ALJ.
- USDA must publish a recommended or interim final decision within 75 days of the end of the hearing, but in no case more than 100 days from the day the hearing initially convened.
  - The Hearing decision should not include a write-up of proposals submitted or an overview of all of the testimony. This information is available on the USDA website. Instead, USDA should write-up why a proposal will be implemented and any appropriate economic analysis and why other proposals were rejected.
- Briefs are due within 15 days of recommended decision being published or within 30 days of an interim final decision being published
- USDA's final decision must be published within 30 days of the briefing due date.
  - A referendum, if necessary is to be conducted within 20 days.
- Any changes to the final decision must be implemented on the first day of a month following no more than 30 days after the announcement of the final decision.

Exhibit 1-a

Dairylea Cooperative's Proposal to Reform Federal Order Rule Making Procedures

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Example Time Table for Federal Order Hearing Process Deadlines Using Calendar Year 2007

Date	Event
Jan 2	Meet with Dairy Division to discuss proposal
Jan 12	Proponent formally requests hearing
Jan 29	Announcement that hearing to be held; additional proposals requested
Feb 13	Additional proposals submitted
Feb 20	Pre-hearing conference convenes
Feb 21	Interested parties request data from USDA
Feb 26	Formal letters sent to entities that proposal request has been rejected
Feb 27	USDA announces hearing date and proposals to be heard
Mar 22	USDA supplies data per requests
Apr 9	Proponent testimony pre-submitted
Apr 24	Opponent testimony pre-submitted
May 7	Hearing convenes
May 18	Hearing Adjourns
Aug 1	Recommended decision published
Aug 16	Interested parties briefs are due
Sep 17	Final decision announced
Oct 9	Referendum concludes
Nov 1	New Order implemented

Mr. Mike Reidy
Senior Vice President
Leprino Foods Company
Denver, Colorado

Before the House Agriculture Subcommittee on Livestock, Dairy, and Poultry

April 24, 2007

Mr. Chairman and members of the Subcommittee, my name is Mike Reidy. I'm the Senior Vice President of Procurement, Logistics, and Business Development for Leprino Foods Company based in Denver, Colorado. Leprino is the largest mozzarella cheese manufacturing company in the world with facilities in California, Colorado, Michigan, Nebraska, New Mexico, New York and Pennsylvania. I'm also Chairman of the International Dairy Foods Association (IDFA).

IDFA and its members are committed to working with dairy farmers and Congress on new policies that ensure a healthy dairy industry. That's why today, at hearings in the House and the Senate, we are releasing our dairy policy proposals for the 2007 Farm Bill, called "Ensuring a Healthy US Dairy Industry: A Blueprint for the 2007 Farm Bill." It can be found at: www.healthydairyindustry.org. Our comprehensive proposals include:

- An improved dairy farmer safety net with direct payments not tied to price or current production;
- Greater access to risk management tools, like revenue insurance and forward contracting;
- A plan to identify needed improvements in the nation's milk pricing system through the establishment of a Blue Ribbon Commission to look at Federal Milk Marketing Orders (FMMO); and,
- Securing long-term trade prospects through repeal of the dairy import assessment.

A copy of our blueprint will be delivered to your office this afternoon.

As our policy proposals suggest, the federal milk marketing order system cannot be viewed in isolation -- it is only part of the government's involvement in dairy. Federal Orders exist along side the decades-old dairy price support program, and the newer Milk Income Loss Contract program that are supposed to operate as the principal "safety nets" for dairy farmers. However, if these safety net programs were working effectively and truly helping today's dairy farmers, I would argue that we would not have the level of controversy and uncertainty over the Federal Order system that brings us here today.

At Leprino, we purchase between 4% to 5% of the nation's milk supply. We have a keen interest in making sure we keep our existing markets strong while finding new outlets for the cheese and other dairy products we produce. As such, I have day to day experience seeing how Federal Orders and current U.S. dairy policies impact the marketplace.

Leprino does not subscribe to the dismantlement of the federal order system -- in fact, while many in the industry think we'd be better off in a deregulated environment, there's no consensus. However, there is increasing frustration with the length of time it takes USDA to make needed changes and mounting concern when decisions finally arrive, because they're escalating regional divisiveness within our industry. This must be examined and improved.

For example, only in the dairy industry do we have to go to the government to ask for permission to update the margins processors can use to cover their costs of turning raw

milk into finished dairy products. It has taken USDA over a year to address this emergency issue -- and while we wait, some cheese companies and cooperatives have closed factories and many others are still challenged to make ends meet.

Today, there is a tremendous amount of strain on the aging Federal Order system with tensions mounting between regions of the country, between manufacturers of different products and among producers and cooperatives. Given the ineffectiveness of federal support programs, additional pressure is being put on Federal Orders to provide income enhancements to producers – a function that Federal Orders were never designed to do and which reeks havoc on the industry. Over the years, USDA has rejected calls from producers to use Federal Orders in this way; however, recent actions suggest USDA may be caving to pressure from certain producer groups to allow the Federal Order system to creep well beyond its congressionally-mandated purpose of ensuring orderly marketing and an adequate supply of milk.

These milk pricing issues are bound to get worse as USDA struggles to make the 1937 Federal Orders fit the business realities of 2007. We need a strategic process to sort out the future of the order system. That's why Leprino supports the creation of a Blue Ribbon Commission to analyze these issues more fully and make recommendations that are built on a consensus among producers and processors.

As a company fully invested in the long-term health and success of the US dairy industry, Leprino believes this committee must pursue a holistic approach to dairy policy. We cannot find our way forward on federal orders unless producers have a reasonable safety net program. We think the structure of the underlying safety nets can change for the betterment of producers and processors.

We support a direct payment program that would decouple payments from price and production, and would be available year round to help farmers. This type of direct payment has the added advantage of not distorting markets, which is good for processors. A complete safety net also needs to provide more risk management tools through forward contracting and revenue insurance.

Finally, our dairy policies should support expanding export market opportunities. This can be done by not erecting artificial barriers to trade like the dairy import assessment, which might lead to retaliation that may threaten any number of U.S. dairy exports, including the whey and lactose products we make.

Mr. Chairman, dairy policies are unbelievably convoluted and many of the programs we deal with today date back to the early days of our country's rural economy. However, the Federal Milk Marketing Orders are perhaps the most arcane. The Federal Order system administered by USDA has always struggled to keep up with the needs of the industry, but I believe the system is now at a crisis point. The level of dissatisfaction with USDA decisions among producers, cooperatives and processors; the frequency, duration and cost of formal rulemaking hearings; the incongruence between what the Federal Order system

was designed to do and what it is trying to achieve today has brought us to this tipping point. Today's hearing could not be timelier.

I would like to explore these issues further, starting with an overview of the origins of Federal Milk Marketing Orders and concluding with our recommendations to improve federal dairy policies.

Federal Milk Marketing Orders are Well-Rooted in the Past

Federal Milk Marketing Orders (FMMOs) were created in 1937 because Congress wanted to make sure that all Americans had an adequate supply of milk for drinking and to protect farmers' bargaining power when selling their milk to processors. This was in the early 20th Century; dairy production in this country was a horse-and-wagon industry of five million small, low-technology farms limited by a processing sector that lacked today's refrigeration, sophisticated transportation equipment and high tech processing methods. Even though we have seen dramatic changes in technology, transportation, and the economics of the industry, the FMMO system is still in place today to assure an adequate supply of milk and orderly marketing.

Federal Milk Marketing Orders operate as a system of ten geographic regions of the country where USDA regulations determine how much processors have to pay for raw milk. FMMOs allow USDA to administer a discriminatory pricing system that assigns prices to raw milk based on the final product it is used to make. The Class I price is the highest price assigned to beverage milks. Class II prices apply to most cultured dairy products and ice creams. Class III prices are paid for milk used in cheese making, and Class IV prices apply to milk used for butter and nonfat dry milk products. There is no other commodity where pricing is regulated by the government based on the end product use of the commodity. Whether corn is used for feed, food, seed, sweetener, oil, or ethanol, its price is set by the market demand for that corn, yet the grower still enjoys a safety net for his income.

Needless to say, there is nothing simple or easy about the Federal Order system. In order for USDA to administer this complex system, milk processors have to track thousands of business transactions, file monthly reports to the ten milk marketing administrators with details about the location and volume of milk purchases, the composition of milk, and how the milk is used. From a purely business process perspective, USDA requires continual manual reporting of virtually all dairy business transactions, and charges processors a fee -- roughly $50 million annually -- to cover the cost of administering the ten milk marketing regions. Essentially, we are paying the government to set our prices.

Today, nearly 70% of the nation's milk is still sold under the USDA federal order milk price system. Most of the remaining milk supply is regulated under California's state milk marketing system, which is outside of the federal system, and a small percentage is unregulated by any system, but highly influenced by it. A small percentage of milk is also priced under other state regulations.

Federal Orders Maintain a Discriminatory System Out of Sync with Today's Industry Structure

Dairy farms today are vastly different than their predecessors seventy years ago. They have grown in size and gained considerable bargaining power through large, well-organized cooperatives. Today, just over 60,000 commercial dairy farms – that's about 1% of the number of dairy farms in the 1930s – now produce over 181 billion pounds of milk a year. That amount is 50% more than the amount produced when the government first intervened in the dairy marketplace to assure adequate supplies. Cooperatives now control as much as 86% of the milk supply, up from under 50% in the 1940s. In 2002, according to USDA, the four largest dairy cooperatives handled 41% of the nation's milk supply. Cooperatives have become huge processors, too, manufacturing over 70% of the butter, over 85% of the nonfat dry milk, 40% of the cheese produced in the U.S. and increasingly, other dairy commodities. Some of these cooperatives are far larger than the processors who are their customers.

Even though Federal Orders regulate how processors pay for their milk, only producers (or their cooperatives on their behalf[1]) get to vote on changes to federal milk marketing orders. This leaves processors as virtual "price takers" once a decision has been rendered by USDA, with prices determined by government formula, not by consumer decisions in the marketplace. The Federal Order system also blocks processors from even offering voluntary forward contracts with producers for milk supplies. Cooperatives are not restricted by FMMOs from offering forward contracts - and they have this power over 86% of the milk supply.

Federal Orders Foster Regional Divisiveness

The FMMO classified pricing system impacts regions differently today because of their historical function. In the 1930s, milk could not be stored or transported very far. So Congress, through the Federal Orders, wanted to ensure an adequate supply of milk close to every populated area of the nation. This was accomplished by setting up a milk pricing system that would equalize producer receipts regardless of how the milk is used (called "pooling") and allow higher prices (through "differentials") close to all major urban areas. At that time, Wisconsin and the Upper Midwest were the major surplus milk production areas. So the pricing system was set up to price fluid milk according to the distance the marketplace is from Eau Claire, Wisconsin. Today's differentials for Class I, or beverage milk, are still based on this concept.

As you might imagine, this regionally based pricing system doesn't fit today's milk markets. Milk production has changed dramatically as have the variety of dairy products demanded by consumers. Through the years, Federal Orders have been changed, but every tweak to these historic pricing formulas creates "winners and losers" where one region benefits over the other or one type of dairy product manufacturer benefits over another. As a further complication, the FMMO system still assigns the highest price to beverage milk, the category that faces declining demand as a percent of the milk supply.

[1] Cooperatives may bloc vote on behalf of their members.

This distorts marketplace signals and creates a problem by stimulating more milk for fluid use than what is demanded - benefiting producers in marketing order regions where most of the milk is the higher priced beverage milk -- but resulting in lower prices in other regions, where most of the milk goes into lower priced manufactured dairy products.

Dairy is the most highly regulated of all U.S. commodities. Dairy is the only U.S. commodity that has a marketing order system that requires the government, at the approval of producers, to set minimum prices and, on top of this, maintains multiple federal dairy subsidy programs. In fact, the United States is one of the few remaining countries in the world that still intervenes in dairy pricing rather than allowing the marketplace to set prices. Other countries allow the marketplace to set dairy prices, and utilize other types of support for the farming section, if any at all.

Federal Order Decision Process is Onerous and Inconsistent

Not only is the Federal Order system complex, it utilizes a slow regulatory process. All stakeholders (producers, processors, retailers and consumers) can petition USDA to change Federal Order provisions. USDA considers the petition and must use a formal hearing and rule-making process to implement changes. It is essential that USDA act as a responsible gate-keeper to hold hearings on only those issues that must be addressed and fixed through the regulated system -- and then make sure the regulatory process is completed in a timely fashion. Both of these issues are concerning and frustrating to the industry.

When USDA decides to accept a petition that starts the formal hearing process, the terms of dairy pricing are subject to change, and all milk buyers and sellers must wait for USDA's decision to learn the impact on their business. The cost and duration of the hearing is exacerbated by the time taken away from operating a business to testify. The FMMO hearings can last days and even weeks and often require expert witnesses, legal counsel, an administrative law judge to carry out the proceedings, and a court reporter to record the proceedings. Hearing participants are required to read their entire testimony into the record, often taking hours to complete this initial step before being cross-examined by a bevy of USDA lawyers and counsel representing other interested parties.

For example, USDA is currently undertaking rulemaking to consider twenty different proposals to update various components of the Class III and Class IV pricing formulas. Deliberations of these technical and seemingly empirically-based issues, such as determining the value of whey cream or the "block-barrel spread", will enter their third week of formal hearings in early July. USDA and industry participants have and will continue to expend tens of thousands of dollars to sit through another week of testimony to comply with the strictures of the formal Federal Order process. This onerous process is nearly as arcane and outdated as the Federal orders themselves. Certainly, a simpler streamlined process, such as the less formal "notice and comment" rulemaking used extensively across the federal government, could be used for the majority of federal order issues. Other improvements, such as utilizing the administrative processes in

California's state marketing order for federal hearings, could be considered a model. California has predefined hearing schedules, and certain time limits that allow the system to work openly and efficiently.

Historically, USDA has also applied a thorough and critical analysis of any and all FMMO petitions before submitting them to the cumbersome and costly formal rule-making process. However, this appears to be changing. At the end of last year -- a year in which U.S. milk production reached a record high of over 181 billion pounds. USDA initiated an "emergency" hearing to consider a proposal intended to raise prices for fluid milk. The decision to go to a hearing on this proposal came as a complete surprise to Class I and Class II milk processors since the supply of raw milk is more than adequate to supply their needs. USDA is required to base the hearing decision on whether the changes are needed to ensure an adequate supply of fluid milk and orderly marketing. Federal Orders were designed for these purposes only -- not to enhance farmer income. In this case, there was really no legitimate reason for USDA to agree to hold a hearing to consider raising Class I and Class II prices. At a minimum, USDA should have solicited industry comments as well as convened a pre-hearing workshop, as it did prior to announcing the hearing to update Class III/IV price formulas, to allow industry participants an opportunity to explore whether a hearing was necessary.

Some issues -- like the margins, or make allowances, that product manufacturers can recover in the price formulas -- must be addressed in the Federal Order regulatory process to keep them current. Updating processing costs imbedded in the formulas for milk used in cheese making, for instance, can only be addressed through the rulemaking process. This should be done regularly and in a timely manner. As a comparison to the Federal Order system, California recently updated make allowances for plants based in California. It took California four months to update the make allowances in their minimum price regulations, and they're already planning the next update. USDA's make allowance update, which was requested on an emergency basis before California even got started, has already taken over a year, and provided less than half the relief that California provided to its cheese makers. Under USDA's proposed make allowance updates, plants across the country will have to sustain their losses or go out of business. This unfortunate outcome is more likely in regions where plants are older and smaller.

There are many examples of how illogical, time consuming, and costly the Federal Order system has become. For instance, in 2005, dairy cooperatives in the Central Order, which stretches from Colorado to Illinois and South Dakota to Oklahoma changed the rules to force any processor seeking to qualify for the producer settlement fund, or "pool", to ship a certain amount of their farm milk to a Class I bottling operation, even though it raised costs and there was no business reason to do so. One company executive told me that he has to ship milk that would normally be processed in a Nebraska Class II plant to a Class I bottling facility over 120 miles away just to participate in the pool. Most shocking, at the same time, he has to do the reverse – that is, transport milk that is produced close to their Iowa plant back to their Nebraska plant. This change forces that company and many others to pay extra transportation costs merely to comply with unnecessary federal

regulations. Can you understand why businessmen who run dairy processing operations are so frustrated with this system?

Complex Regulations Restrict Market Growth Opportunities

Dairy companies struggle against Federal Order regulatory hurdles, which put them at a competitive disadvantage in competing with other food and beverage manufacturers. The outmoded Federal Order system is not built to allow dairy to succeed in the highly competitive beverage market where other products are not constrained by cumbersome regulatory pricing mechanisms. For other agricultural commodities, unencumbered by price regulation, there are reliable risk management tools for both suppliers and buyers. Commodities purchased by most food processors have market price discovery. Commodity buyers can reliably plan for and even lock in future prices and have regular access to forward contracts with their suppliers. Not so with dairy. Uncertain changes in price regulations, and the lack of universal access to forward contracting and futures markets, means that dairy is increasingly at a disadvantage in the food and beverage marketplace. There is a strong price incentive for buyers to substitute or minimize the dairy protein components in food products – an otherwise growing but competitive market.

The classified pricing scheme also conflicts with the current demand for dairy products. The system was erected to ensure the availability of fluid milk by assigning it the highest price. However, fluid milk consumption has been on a steady decline. In fact, per capita sales of fluid milk products in 2005 were only 21 gallons, the lowest level on record. Conversely, the demand for yogurts, cheeses and many dry milk products has soared. The increasing demand for dry dairy ingredients, especially dairy proteins, is being driven by products such as pizza, snack foods, sports drinks and nutrition bars. Additionally, cheese and its by-products now account for more than 40% of the U.S. milk supply. Despite this shift, Federal Orders still require the highest prices to be paid for fluid milk, making it more expensive to purchase farm milk for processed products while only providing farmers with a "blend" or average price of all the milk used in their Federal Order marketing area.

An example of marketplace evolution that is hitting up against federal order pricing constraints is whey, a byproduct of cheese that has been unconstrained by government regulation. For years whey was traded in the open market; its price not influenced by an underlying USDA purchase program. Over time, market demand grew because of competitive pricing, and whey products are now valuable ingredients for a myriad of food processing, animal feed and industrial purposes. Exports of whey products have taken off, and because of the increased demand, whey prices have also increased. But even something that has been a success in markets has caused problems in the federal order pricing structure for cheese plants. The federal order price for cheese incorporates a new higher value for whey, so all cheese processors must pay a higher price for their milk, but not all processors are equipped to get value out of the whey to cover the higher cost of the milk. This translates to losses for many cheese plants. This is just one more example of how markets move over time but the Federal Order system can't keep up.

An Ineffective Dairy Farmer Safety Net Compounds Federal Order Problems

Problems with the Federal Order system are compounded by ineffective support programs for dairy farmers. Current safety net programs put in place years ago no longer fit the dairy industry and markets of today. The dairy price support program is intended to keep average prices from falling below a minimum support price, but today's marketplace realities yield it ineffective. While doing nothing to support farm income, maintaining the price support structure only continues to encourage production of basic commodities for a guaranteed market (the government) instead of retooling these manufacturing facilities to produce more products now in high demand in the marketplace, such as high protein milk concentrates and powders.

On top of that, some of the problems attributable to the price support program have been compounded by the Milk Income Loss Contract (MILC) program, which was overlaid on the price support program by the 2002 Farm Bill. These programs work at cross-purposes. The price support program is intended to establish a safety net floor under milk prices-- that is, milk prices are allowed to fall enough to send a signal for the market to adjust. But, when the market price has fallen toward the price support level and thus is calling for an adjustment in supply, the MILC program kicks in. This sends the opposite signal telling farmers to continue producing milk at the same or greater levels. This, in turn, has a further dampening effect on prices, keeping them at low levels for longer periods of time. The two programs are completely counter productive and can result in more federal spending and less economic security for producers. Under certain market conditions, USDA is essentially paying for milk twice with little or no benefit to the producers.

Under today's market conditions, futures markets are projecting record high milk prices, so no MILC payments will be triggered, yet farm income is severely squeezed by soaring feed costs. This is the ideal time to transition away from the concept of buying commodities and payments tied to price and production and to put scarce government resources toward a safety net that helps farms but encourages markets.

In short, dairy policy is based on outdated supply concerns, instead of solutions which support farm income without negative marketplace impacts that can result in weakening demand for dairy products. MILC was new and untested in the 2002 Farm Bill -- now we need to take the lessons learned and fix the payment program to get it right. Price support is an illusion of security, and should be replaced with real tools that help manage price volatility, and maintain revenue. Now is the right time to make these updates in dairy policy, while demand for dairy products is strong. Congress should phase out the dairy price support program and transition MILC to a new safety net not linked to price or production. This would provide farmers with reliable support, help markets work more effectively, and position the U.S. for continued success in a growing global marketplace.

<u>Federal Orders Are at a Crossroads – A Commission Can Provide a Roadmap for the Future</u>

Dairy processors are not in agreement on the future direction of the Federal Orders, but there is a strong level of discontent with the current system. There are many issues currently being discussed. For example, California's state milk marketing order system is often held up as being faster and more efficient in adjusting regulations to marketplace realities than the federal order system. However, California's quota system is also seen as an impediment to California becoming part of the federal system. But the need for comprehensive reform goes far beyond just these observations. California's administrative processes should certainly be considered as a model of great efficiency, but California should not be brought into the broken Federal Order system without full and adequate study. Furthermore, expanding the Federal Order system to make one national order is also a losing proposition that will only make the pricing system's failings more apparent, accentuating regional disparities and uncertain impacts on consumers.

The Federal Milk Marketing Order system has been around for seven decades – correcting its well-entrenched problems won't be something that can be addressed within the next few months in the heat of a farm bill debate. But, we have a good context for analyzing the Federal Order system and developing a solution:

- The Federal Order system was designed to ensure a local fluid milk supply -- and that's not a problem today;
- The Federal Order system is not a safety net; there are other programs for that purpose;
- Solutions to our current problems cannot be addressed piecemeal because the entire federal dairy policy system is interrelated;
- Record high milk prices and growing global demand provide a golden opportunity to make significant portions of these interrelated dairy programs more market oriented.

A Commission is needed to study these issues, and pull together the different stakeholders to assist the industry in reaching consensus on the next steps as it relates to the Federal Order system. A national approach, representing the diversity of the industry is the only way that we will be able to get past the individual "winners" and "losers" that would be the outcome of a piecemeal approach.

USDA faces a virtually impossible task of trying to administer a discriminatory, regional pricing system that was built for the marketplace of the 1930's. Today's industry has been fundamentally reorganized and is subject to an entirely new array of market forces. Like a decades old car, the Federal Order system can keep sputtering along, but it needs more than a tune-up -- the Federal Order system needs to be completely rebuilt for the 21st century. In short, it's time to buy a new car. We need a Federal Order Blue Ribbon Commission established in the 2007 Farm Bill to chart the course for the future of milk price regulation in the U.S.

The stakes are high. The dairy industry has grown up around the classified pricing system, and any future changes need to be done thoughtfully and carefully – with balanced input. In the meantime, it is essential that Congress immediately address the issue of a new federal safety net for dairy farmers. Without this, all dairy programs and policies are at the risk of collapse.

Federal Orders and the Safety Net Are Inextricably Linked: Both Need to Change

As I started out by saying, the Federal Order system cannot be viewed in isolation -- it is only part of the government's involvement in dairy. It cannot continue in its current direction of acting as a price support program, without severe negative impacts on the market, such as declining milk demand and increased friction in the industry. The pressure must be taken off of the system by fixing the underlying safety net programs.

The future success of our dairy industry also requires a transition from ineffective policies of the past, to programs that distribute resources more equitably, promote expanded trade, and address today's challenges. In structuring a viable safety net, two important principles come into play. First, we must recognize that price-triggered payments don't help when both milk prices and input costs are high. Second, we must also recognize that it is possible to protect revenue without manipulating prices or disrupting production in the marketplace.

Dairy Needs Improved Direct Payments and Revenue Protection

We support a safety net that will make payments directly to farmers, year round, even at times of higher farm milk prices. A decoupled direct payment program will help farmers of all sizes address higher feed costs, and the higher costs of energy, and environmental compliance. At the same time, we support risk management tools that directly help producers manage price volatility and revenue fluctuations. Unlike the price support system, we think the safety net needs to be directly accessible to producers through options such as affordable revenue insurance. Milk prices are among the most volatile of all agricultural commodities, in part due to the very federal programs that intervene in the marketplace. Revenue insurance is needed to offer farmers the option of bottom line protection against severe declines in farm revenue associated with price fluctuations and natural disasters. But there is no revenue insurance product currently available specifically to meet the needs of dairy producers. Unlike dairy, most major crops in this country have access to and extensively utilize USDA subsidized insurance products, including farm revenue insurance. If milk revenue insurance were available, it would enable producers to make better long term strategic plans for their businesses and make farm investments with greater certainty.

Permanent Dairy Forward Contracting will Expand Risk Management Tools

Congress should remove restrictions on preventing thousands of dairy farms from using forward contracting of milk sales to protect against future severe milk price downturns and to enhance revenue predictability for planning purposes. USDA operated a pilot

program during 2000-2004 that allowed forward contracting for milk that goes into cheese, ice cream, butter and nonfat dry milk, and found that forward contracts were effective in achieving stable prices. USDA also determined that making the dairy forward contracting pilot program permanent will not hurt or undermine the Federal Order system.

In fact, the forward contracting pilot program under USDA's oversight was quite successful for both producers and processors alike. Structurally, a system of forward contracting can streamline the communication of market-based information from the consumer all the way to the producer and thus addresses one of the key problems in dairy price risk. Managerially, forward contracts are relatively easy to use. There is no cash settlement, no premium payment, and no monetary outlay on the part of the producer. The terms, nomenclature and concepts are not foreign to the producer or difficult to learn like futures and options trading. Forward contracting is a very simple and user-friendly risk management tool.

We support Congress making the forward contracting program permanent in the 2007 Farm Bill, with the same level of USDA oversight and no additional USDA restrictions that would create unnecessary bureaucratic red tape.

Promote Long Term Trade Prospects -- Repeal the Dairy Import Assessment

The U.S. dairy industry is in an excellent position to capitalize on growing global demand for dairy products. The U.S. Dairy Export Council estimates that global demand for dairy products will increase by more than 20% in the next few years. With world market prices for dairy products at their highest levels in recent memory, the time is right to reduce our dependency on trade-distorting federal programs, such as the dairy price support program, and eliminate needless trade barriers like the dairy-product import promotion assessment program.

Although the dairy import assessment has not been implemented since it was enacted in 2002, it hangs like a cloud over our industry just as we are poised to capitalize on global trade opportunities and move toward leadership in market-oriented innovation. The assessment would not give any additional support to farmers, but is in violation of our global trade obligations, and is likely to provoke a challenge through the World Trade Organization and risks retaliation against U.S. exports of all types. Imported dairy products would be required to pay into the domestic promotion programs, but these products would not benefit from the advertising and other promotion activities. Fluid milk imports are virtually non-existent and the volume of cheese imports is capped by strict quotas. Imported high protein dairy ingredients, use predominantly in products outside the dairy case, would not benefit from cheese and milk advertising.

Congress should use the opportunity offered by the 2007 Farm Bill to repeal the assessment and help make federal dairy policy more consistent with the nation's global trading obligations.

Conclusion

We recommend a two step process to get dairy policies in line with where the industry is today and position the dairy industry capture greater demand for dairy products here and abroad. First, fix the safety net and ensure that our dairy policies support expanding export market opportunities. The authority for the MILC and price support programs are coming to an end with this Farm Bill, offering Congress an opportunity to put a more viable safety net in place. The safety net can be improved by transitioning MILC from a trade and market distorting program into a decoupled direct payment program, while phasing out the price support program, and offering more risk management tools for dairy producers through forward contracting and revenue insurance. Along with removing artificial barriers to trade like the dairy import assessment, these new ideas are fair to all farmers, don't distort the market or hamper demand for dairy products, and are consistent with U.S. trade goals.

Second, establish a blue ribbon commission made up of producers, processors and experts to recommend ways to streamline and simplify the system, increase its responsiveness to market forces, and ensure that it's still serving the best interests of the industry and consumers. The time to implement the longer term solutions to fix the Federal Milk Marketing Order system will follow after the commission has reached consensus and issued recommendations.

IDFA represents companies -- large and small, public, private, and producer owned -- that build demand for U.S. dairy products; and who are dependent upon a stable and healthy U.S. milk production sector. We support and uphold the importance of federal programs that ensure dairy producers have equal standing to operate their dairy businesses to take advantage of growing markets in the U.S. and abroad.

U.S. milk production was at a record high in 2006 at over 181 billion pounds. If our milk supply continues to grow as it has in the past (production has increased by over 50 percent in the past 30 years), protecting the processing sector's capacity to buy more and more milk -- that is, to grow demand -- is equally important to ensure a healthy dairy industry. Members of this subcommittee understand this obvious point, but it needs to be reinforced that a safety net for farmers does not help farmers in the end, if those very government programs negatively impact the outlets and growth opportunities for milk and dairy product demand here and abroad.

Statement of
Mr. Warren Erickson
Executive Vice President & COO
Anderson Erickson Dairy Company
Des Moines, IA
Before the House Agriculture Subcommittee on
Livestock, Dairy, and Poultry
April 24, 2007

Thank you for the opportunity to be here today. I'm Warren Erickson, Chief Operating Officer of Anderson-Erickson Dairy Company in Des Moines, Iowa. I am a third generation dairy operator and run the company with my sister and father. AE is one of the few remaining, large independently-owned dairies in the country. You know our company well, Mr. Chairman, and I would like to thank you for your leadership as our Congressman on behalf of the Iowa dairy industry.

I came back to my family's dairy business after some time in the accounting industry. And, I'm here to tell you that complicated accounting and tax regulations can't hold a candle to Federal Milk Marketing Orders. That is why, we support Congress creating a Commission of industry experts and USDA officials to look at the future of the Federal Milk Marketing Orders and the problems that plague the system. Here are just a few we have experienced, for example:

- After 70 years, the federal government still operates a discriminatory pricing system that assigns prices to milk based on the products it's used to make. At AE, we pay the highest prices because we produce fluid milk, known as Class I, and yogurt and other cultured products, known as Class II. There are also two other classes – Class III for milk used to make cheese and Class IV for milk being turned into butter and powder. As far as I know, no other perishable commodity in America regulates prices this way. And there is no real reason milk should be.

- For fluid milk processors, like us, we also pay more for our milk based on a system that originally priced milk according to the distance of a plant from Eau Claire, Wisconsin. Known as "Class I differentials" today, you can see from this map that the price of Class I milk still goes up the further you get from Eau Claire. This regional based pricing method doesn't fit today's economics or dairy industry.

- And, I can tell you from first-hand experience that the formal rule-making process used by USDA to modify complicated Federal Order rules is unresponsive based on the realities of our business environment, unreasonably slow and costly to everyone involved.

Here's an example of how out of touch the Orders are. We buy from both co-op and independent farms at AE. We have a new dairy farm in our area and we plan to buy their milk. But, how do I explain that the Class I price – reported each month from USDA, is what I pay for the milk, but not what my farm suppliers receive? In frustration, I refer to it as a communist system where the market administrator tells me what to pay, instead of what my supplier and I both agree on is a fair price. In addition it is exceedingly complicated to explain to the supplier what they will receive as payment for their milk shipped to AE. A more straightforward approach would be much easier for all parties involved.

At AE we would value being able to directly forward contract for the milk going into our yogurt products – it's a simple, understandable, and voluntary price agreement that would take the guess work out of milk procurement for me and my farmers. Please fix this by reauthorizing the dairy forward contracting pilot program in the Farm Bill.

But Federal Orders have bigger problems than restricting the use of forward contracts. For example, several years ago I testified at a USDA hearing on the implementation of congressionally-mandated Federal Order Reform. Can you imagine being cross examined by USDA officials on the interplay between cheese, butter and powder prices, and the distance of my plant from Eau Claire, Wisconsin? I gave it my best shot.

After three years of deliberations during the last Federal Order reform, countless hours of testimony and hundreds of thousands of dollars spent by processors, co-ops and the government on the process, USDA ultimately proposed a more market-oriented pricing system. However, Congress intervened and mandated a different scheme with higher Class I differentials. This result hit our bottom-line pretty hard. Higher prices for our milk lead to less consumption, which not only hurt my business but hurt our dairy farmers as well.

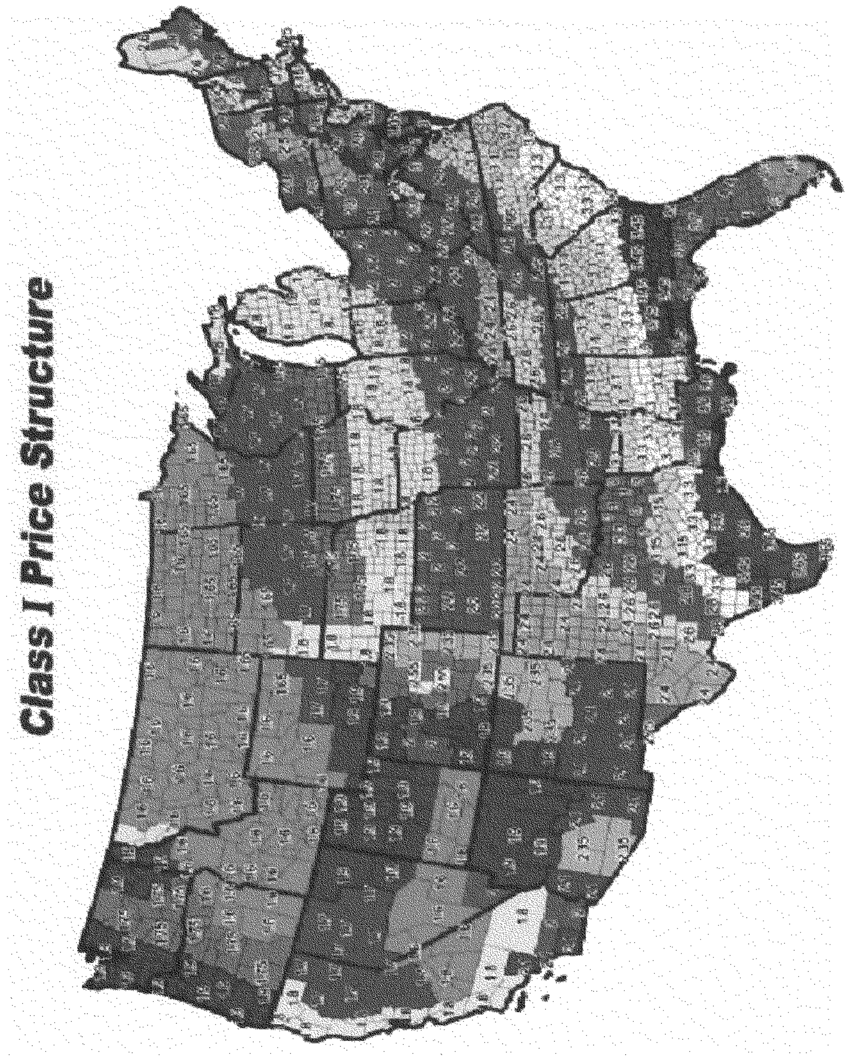
From my perspective, a pricing system that makes my milk from Iowa more expensive than milk sold to a Minnesota cheese plant, but less expensive than the price of milk in Florida doesn't make sense.

You see now why we have this tension in the system – the outcome is always different depending on where your farm or plant is located, and what the milk is used for. There has got to be a better way.

However, no one can agree on how to fix the Federal Order system. And, fixing it will not be an easy or fast process because the problems are so complex and solutions so politically-charged.

Mr. Chairman, I believe Congress can rise above the regionalism and divisiveness that comes with trying to solve such problems in the political arena by charging the dairy industry to work together to find a consensus and solve our own problems. That is why we support Congress creating a commission made up of producers, processors, USDA officials and experts to recommend ways to streamline and simplify the system, increase its responsiveness to market forces, and ensure that it's still serving the best interests of the industry and consumers.

In spite of all of the complications and uncertainty, AE will continue to do our best to meet our consumers' demands and try to increase milk and dairy consumption. We will continue to do business according to the high standards of quality my grandfather used when he started our company 77 years ago. In the short term, please give us some assistance by establishing a Federal Order commission. Thank you.


Class I Price Structure

Statement of
Mr. Douglas J. Wells
Co-President
Wells' Dairy, Inc.

April 24, 2007

Before the House Agriculture Committee
Subcommittee on Livestock, Dairy, and Poultry

Mr. Chairman, congratulations on your Chairmanship and thank you for the opportunity to be here today. As you know, Wells' Dairy has given Le Mars, Iowa, the distinction of being the "Ice Cream Capital of the World." Our Member of Congress, Representative Steve King, also serves on this subcommittee, so with you and Representative King, Wells' feels like the Farm Bill is in good hands.

As a large regional processor serving a national market, federal orders and our nation's dairy policies greatly impact our business.

At Wells' Dairy, we are constantly looking for ways to make our business processes faster, more efficient and reduce waste. Competition in the dairy industry is challenging and our margins are squeezed very tightly. We have a strong relationship with our suppliers and we take pride in dealing with all family owned farm businesses.

Unfortunately, Federal Milk Marketing Orders and other federal dairy programs are based on outdated, inefficient business models that in many ways impede our ability to increase sales of dairy products in the marketplace. This isn't good for our business or for farmers, and we think the programs need to change. Since 1976, milk consumption has declined by 36% to 21 gallons per capital in 2005 - the lowest level on record.

Looking back, Federal Orders played an important role -- helping to stabilize the milk supply after the Great Depression and through World War II. However, with our modern infrastructure and a growing milk supply, we need to ask, "Do Federal Orders help us or hurt us in making today's dairy producers and processors more competitive in the marketplace?"

I can't think of any other business in America, outside of dairy, where the government sets the price, constrains my allowable overhead costs, requires manual reporting of what is bought, manufactured, transported, and sold; and then charges us – the milk buyers - for the cost of administering this system.

Let me give you an example of how illogical, time consuming, and costly the system has become. Wells operates partially in the Central Order, which stretches from Oklahoma to South Dakota and Illinois to Colorado. In 2005, the rules changed so that now, to qualify for the producer settlement fund, or "pool", we have to ship farm milk that would normally be processed in our Omaha yogurt plant to Le Mars. At the same time, we have to do the reverse – that is, transport milk that is produced close to our Le Mars plant to the Omaha plant. This change has increased our transportation costs, for no logical reason, but merely to comply with unnecessary federal regulations. Can anyone imagine a business voluntarily swapping inventory between two plants? Perhaps even worse, Federal Order rules didn't allow processors to vote on this decision ... only dairy farmers, or more pointedly their coops, were the only voters.

Wells competes with companies inside the Federal Orders, with California which is outside the federal system, and with some unregulated plants. You've heard how cumbersome and slow the regulatory pricing system is. And, you have probably heard of ideas being discussed to "fix the system" - such as, bringing CA into the federal system, or making one national order. It is impossible to generalize about the impact of these proposals on Wells' Dairy -- the devil is in the details -- that is why we need a Commission to study and make non-politicized recommendations and wring as much inefficiency out of the system as possible. We can look to California for a possible model to consider. Their system does have speed and responsiveness in making cost changes.

Mr. Chairman, that brings me to another important point. One way to improve the system is to take away some of the uncertainty, and better manage price risk, by allowing producers and processors to forward contract. Because of Federal Orders, processors like Wells are restricted from working out price agreements, or forward contracts, with producers. Wells participated in USDA's dairy forward contracting pilot program, until it expired in 2004. The program was successful in helping farmers go into business in Western Iowa. We need to get this basic risk management tool back. And please, in the process, don't add unnecessary paperwork and oversight. Dairy processors and producers are sophisticated business people, and we do not need additional USDA handholding.

Mr. Chairman, bringing back the dairy forward contracting program is the number one Farm Bill issue for us at Wells Dairy. Forward contracting will help us plan ahead to ensure that Iowa's processing capacity can handle Iowa's growing milk supply. Forward contracting will make it easier to do long-term planning and attract needed investment in farms and plants. I can tell you from first hand experience it helped dairy in Iowa grow.

I want to finish on the point I started out in this testimony -- business efficiency can only go so far unless it is complemented by government efficiency. We need more efficiency in the Federal Order system - and to find the right solutions will require a well thought out consensus from a Commission of experts -- not quick fixes. Unrestricted use of dairy forward contracting is also needed to ensure that all milk buyers and sellers can achieve greater price stability -- a key component in any successful business plan.

Thank you for your time today.

Mr. William Ahlem

Co-Founder and Vice Chairman of the Board

Hilmar Cheese Company

Hilmar, California

Before the House Agriculture Subcommittee on Livestock, Dairy, and Poultry

April 24, 2007

William Ahlem

Mr. Chairman and members of the Subcommittee. My name is Bill Ahlem and I would like to thank you for the opportunity to speak. I am a co-founder of Hilmar Cheese Company and one of its twelve family farm owners. Hilmar Cheese Company is the largest single-site cheese and whey products manufacturer in the world. I will start by stating that like Doug Wells , I am confident that the Farm Bill is in good hands with our Member of Congress, Dennis Cardoza on its Subcommittee.

I have been a dairy farmer my entire life and it is a privilege to be here today to talk about Federal dairy policy. My perspective comes from being an active dairy farmer and processor in California's milk marketing system and soon will include the Federal system with our new cheese plant under construction in Dalhart, Texas.

Relationships between dairy manufacturers and dairy farmers have changed dramatically during the last couple of decades. Today, process ownership is vastly controlled by dairy farmer-owned co-ops and private processing plants such as Hilmar

Cheese Company.

The more seamless and more market-driven the relationship between processors and dairy farmers, the more prosperous the entire dairy sector will be. Furthermore, government expenditures will decrease dramatically because it will eliminate costly government programs.

Acknowledge for example the cheese manufacturers and plants going out of business, particularly in the Midwest. The elaborate government involvement in these markets and the distortion of signals based not on contemporary markets has much to do with the reason dairy manufacturing plants cannot survive. We, as a dairy sector in general would be better off without time consuming, cumbersome and complicated orders that are open for misinterpretation and bias, making it impossible to reflect the dynamic changing marketplace. Why are we denied the tools of forward contacting and revenue insurance programs as a safety net, yet we have programs such as Commodity Credit Corporation (CCC) that discourage innovation and negatively affects producers by way of purchasing their product at a support price and later releases

the same product often flooding markets and prolonging low prices. In essence, the perceived safety net that is the CCC is really a double hindrance in establishing marketplace value for our dairy products.

Federal Order regulations and other dairy policy react very slowly to contemporary market signals.

California's system on the other hand is much more responsive to contemporary market signals. By comparison for example, USDA's proposed make allowance update that was requested on an emergency basis has already taken more than a year. California on the other hand was able to get greater relief in a timely response.

This is just one example of why I don't see any benefit to California joining the Federal Order system.

We support programs that do not interrupt market signals. This is why we do not support the M-I-L-C program. It stimulates production increases and mixed price signals.

We should be focused on expanding markets for our valuable dairy sector, not distort it with out-of-date and ineffective government purchase programs that discourage innovation and prolong low prices.

We also need help dealing with pressing issues such as labor and managing the cost of environmental regulations. Passage of the "Ag Jobs (Guest Worker)" bill is vitally important to dairy. Conservation-related direct payments, which could replace M-I-L-C, could be a way to help farmers deal with environmental compliance and rising feed costs.

I will end by saying that I support what many have said at this hearing. Not only does the Federal Order system need to be thoroughly examined, but the relationship between government and dairy enterprise needs to be evaluated to ensure that we are responsive to the market signals of today's world. Relying on California and merely adopting their process will not solve our problems. I think a better first step would be to get everyone in the same room to discuss the future of the Orders in general. And, more immediately, act on issues that truly help dairy producers and processors: increasing trade, decreasing

unnecessary regulation, and helping us deal with our labor issues and environmental challenges.

Thank you.

Mr. John Hitchell
General Manager, Raw Milk Procurement & Regulations
The Kroger Co.
Statement before the House Agriculture Subcommittee on
Livestock, Dairy, and Poultry
April 24, 2007

As the last speaker on the panel today, Mr. Chairman, I'd like to thank you for your patience and interest in the Federal Milk Marketing Orders.

My name is John Hitchell, and I am the General Manager, Raw Milk Procurement & Regulations for the Kroger Co. headquarted in Cincinnati, Ohio. Kroger operates 17 dairy plants in 14 states that manufacture a variety of milk, ice cream and yogurt products that we sell in approximately 2,500 retail stores in 31 states.

I will keep my comments brief. After listening to all of the speakers today, I'm sure the issues and challenges surrounding the Federal Order system are clear.

Kroger has a special role on this panel as we sell directly to consumers and believe this process, the marketing of milk and government regulation of the US dairy industry, is intended to work for consumers as well as farmers. My comments today are shared with our customers in mind.

As others have acknowledged, it is not an easy task for USDA to continue to operate a government milk pricing system that has grown more complex through the decades. I have to give USDA credit – they've tried to make the rulemaking process easier to understand and allow for more dialogue within the industry. For instance, recently they held a pre-hearing workshop to discuss proposed changes to how milk that goes into cheese, non-fat dry milk and butter is priced.

Even more important, the pre-hearing workshop allowed USDA to consider the proposed changes before deciding on whether to start the formal rulemaking process. USDA is required to base the decision to hold a hearing on whether the changes are needed to ensure an adequate supply of fluid milk and orderly marketing. So, this type of workshop allowed all interested parties to help USDA understand the "real world" impact of various proposals in a constructive, open and transparent dialogue.

However, less than one week after the pre-hearing workshop, USDA commenced an emergency hearing on a separate issue to make changes to the Class I/II formulas. There was no pre-hearing session this time, which was concerning to The Kroger Co. because these changes would have a significant impact on the cost of the Class I and Class II products we process and the customers we serve.

I'm sharing this recent experience with you to point out the need to have a more open process and a predictable pattern, before starting formal Federal Order rulemaking. It takes a lot of time and money to get through these hearings, and they increasingly result in more complex changes to the government's milk pricing rules. The bar on whether USDA should go to a hearing should be consistent, and set high. Federal Orders were designed to set a minimum price to ensure the orderly marketing of milk and an adequate supply, not to enhance farmer income. Whether you like them or not, other government programs, like M-I-L-C, are there to perform that task. And, a thoughtful and judicious approach to Federal Order rulemaking would allow USDA adequate time to consider the potential impact on consumers as well.

Even more than the effect on our business or our milk suppliers, USDA needs to be the gatekeeper to make sure this system works for the people who are consuming milk and dairy products everyday. In reality, they are the engine that is driving this train and our future prosperity demands heavily, some might say exclusively, on their willingness to continue to consume dairy products. If we make this system too complicated or costly to meet consumer demands, then they may go elsewhere to fulfill their nutrition needs. And, I can tell you, once you lose a customer; it's awfully hard to get her back.

In the same way, we need to have an open and constructive dialogue in planning for the future of the Federal Order system and we have to broaden our perspective to take into account the impact of Federal Order decisions on consumers. That's why I join others here today to urge you to put in place a Blue Ribbon Commission to do just that in the

Farm Bill. A Commission will allow us to talk about important and complex Federal Order issues, and the various proposals that have been considered to change the system.

I would also suggest that one of the commission's primary responsibilities be to ensure that the Federal Milk Marketing Order system serve the interests of milk and dairy product consumers, as well as farmers and processors. We look forward to working with Members of this subcommittee, USDA, dairy farmers and our fellow processors to achieve this goal.

Thank you again, Mr. Chairman, for consideration of these issues.

CHEESE REPORTER

Friday, April 20, 2007

GUEST EDITORIAL

Predictability Needed In Federal Order Hearing Process

By Geoffrey Vanden Heuvel

Editor's Note: The following letter addresses our editorial of April 6th, entitled "Congress Needs To Fix Federal Order Hearing Process."

Dear Dick Groves (Editor of "Cheese Reporter"),

The appeal of quick milk hearings is like the lure of simple tax codes – great in rhetoric, bad in practice. Hearing decisions at both the California and the federal level must be based on the hearing record, that body of information that is presented at the hearing.

As you point out in your editorial, the California hearing process does not allow witnesses to be cross-examined by non-department personal. The practical effect of this is that anyone can make any claim, and unless the department staff asks about it, it stands unchallenged in the record.

The California department staff in recent years has limited their questions to simply questions for clarification. There have been a couple of hearings on major issues in the past three years where they have asked almost no questions.

What this leads to is a hearing record that has massive amounts of information in it, witnesses and the department itself enter thousands of pages of documents and statistics, but none of it tested. The information can be contradictory and of course subject to widely different interpretations.

But without the benefit of cross examination the contradictions and interpretations are not critically evaluated in the hearing record. The practical effect of this is that the hearing record does not act as a constraint on the California secretary's ability to make a hearing decision.

Constraining the authority of the secretary is what hearings are for.

Congress has given the United States secretary of agriculture broad authority to set milk prices in the federal orders. But Congress has required hearings to be held and set criteria which the secretary must consider when exercising his authority.

The reason FMMO hearings are contentious is because big issues are at stake and various segments of the industry are trying to restrain the secretary's authority by what gets placed into the hearing record. Cross examination of witnesses is absolutely essential to making sure the hearing record is tested.

Without a tested hearing record what you have is a dictatorship of the secretary. That may be good or bad for any individual party depending on whether the secretary rules in your favor or not. But it is not good public policy.

In my opinion the problem with the FMMO hearing process is that there is no predictability to the decisionmaking timeline. That is something California is good at.

You do know when California will produce a hearing decision. The quality of the decision is what is suspect in California.

Ultimately, Congress will probably need to give direction to USDA to fix the hearing process. An enforceable decision timeline would be the best improvement they could mandate.

But witness cross examination must continue or we might as well get rid of hearings altogether and just let the secretary do his thing.

Geoffrey Vanden Heuvel, Dairy Farmer

Response from "Cheese Reporter" Editor Dick Groves:

Geoffrey,

First, thanks for your thoughtful response to my editorial of April 6th. I'd like to address a couple of points in your letter.

I certainly agree that the lack of predictability in the decision-making timeline is one of the problems of the federal order hearing process. What really prompted my April 6th editorial was the reconvening of the hearing on Class III and Class IV prices.

As it turns out, I probably underestimated the problem. That reconvened hearing lasted all of last week, and will now reportedly be reconvened again, this time not until July.

California, as you point out, is good at providing predictability in its decision-making timeline, and probably would be able to issue and implement a decision in the time it is going to take the federal order system just to complete this price hearing. That stretched-out, never-ending (or so it seems right now) process is a disservice to everyone.

Perhaps disallowing cross-examination is a bit harsh. Certainly, allowing opponents to challenge testimony is an important part of the hearing process.

However, I'm not sure those challenges need to be open-ended or unlimited. For example, the idea of allowing three-minute statements in support of or opposition to Dairy Institute of California's proposal at California's price hearing last June allowed a lot of people to weigh in on that proposal in just a one-hour period.

All those who testified also were given the opportunity to submit post-hearing briefs, which are also a way for interested parties to rebut or support hearing testimony in the federal order process. And these briefs don't just sit at USDA gathering dust; they are part of the hearing record, and a check of a couple of recent USDA decisions confirms that hearing testimony as well as post-hearing briefs are considered when USDA makes a decision.

So maybe a compromise is needed as far as cross-examination is concerned. One way to do this would be to put a time limit on it, and then instruct questioners to express further concerns or challenges in their post-hearing briefs.

Another way to do this might be to limit cross-examination to people who aren't paid by the hour, or to people who have flights to catch later that day.

You state that the "quality of the decision" is what is suspect in California, but I'm not convinced the more thorough (lengthy and detailed) federal order process does any better. Here, we do agree to some extent.

To me, part of the "quality" of any decision lies in how quickly it's issued and implemented. We both support an enforceable timeline, which should boost the quality of any decision, no matter how much cross-examination is allowed.

Dick Groves, Editor